

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1959

No. 283

**THE HERTZ CORPORATION, A CORPORATION
(SUCCESSOR BY MERGER TO J. FRANK CONNOR,
INC., A CORPORATION), PETITIONER,**

vs.

UNITED STATES OF AMERICA.

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

**PETITION FOR CERTIORARI FILED AUGUST 6, 1959
CERTIORARI GRANTED OCTOBER 12, 1959**

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[fol. A]

**IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

No. 12,799

THE HERTZ CORPORATION, a corporation (SUCCESSOR BY
MERGER TO J. FRANK CONNOR, INC., a corporation), Appellee,

v.

UNITED STATES OF AMERICA, Appellant.

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT
COURT FOR THE DISTRICT OF DELAWARE

Appellee's Appendix—Filed April 3, 1959

Roswell Magill, 15 Broad Street, New York, New
York; Harry N. Wyatt, 33 North LaSalle Street,
Chicago, Illinois; Edgar Bernhard, 33 North La-
Salle Street, Chicago, Illinois; Donald J. Yellon,
33 North LaSalle Street, Chicago, Illinois; John
C. Klett, Jr., 15 Broad Street, New York, New
York; Attorneys for Appellee.

Of Counsel: Cravath, Swaine & Moore, 15 Broad Street,
New York, New York; D'Ancona, Pflaum, Wyatt & Riskind,
33 North LaSalle Street, Chicago, Illinois.

[File endorsement omitted]

[fol. 1]

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

COMPLAINT

[Omitting all exhibits thereto.]

Now comes The Hertz Corporation, a corporation, Plain-
tiff herein, by S. Samuel Arsht and Edwin D. Steel, its at-
torneys, complaining of the Defendant, United States of
America, and says:

1. The nature of Plaintiff's claim against Defendant is as follows: For the recovery of moneys erroneously and illegally assessed and collected from J. Frank Connor, Inc., a corporation, predecessor by merger of Plaintiff, as income taxes for the fiscal years of J. Frank Connor, Inc. ended March 31, 1954, March 31, 1955, and March 31, 1956, by the District Director of Internal Revenue in Newark, New Jersey, in the aggregate amount of \$14,561.12, as follows:

Year ended March 31	Income Tax
1954	\$ 100.15
1955	4,044.54
1956	10,416.43
Total	<hr/> \$14,561.12

2. This action arises under the Internal Revenue Code of 1954 (and, more particularly, Section 7422 of the Internal Revenue Code of 1954 [Section 7422, Title 26, United States Code]), and under Title 28, United States Code, Sections 1340 and 1346(a)(1), as amended.

3. J. Frank Connor, Inc., hereinafter sometimes referred to as "Connor", was duly organized as a corporation under the laws of the State of New Jersey on April 2, 1947. It continued in existence, with its principal office and place of business at 85 Plane Street, in the City of Newark, County of Essex, State of New Jersey, until July 5, 1956.

[fol. 2] 4. At all times material herein, Connor was on the accrual basis of accounting, keeping its books of account and filing its Federal tax returns on the basis of a fiscal year ending March 31, in accordance with the method of accounting regularly employed on the books of account of Connor.

5. Plaintiff, The Hertz Corporation, hereinafter sometimes referred to as "Hertz", is a corporation duly organized and existing under the laws of the State of Delaware. Its principal office in the State of Delaware is located at No. 100 West Tenth Street, Wilmington, Delaware.

6. Connor was merged into Hertz on July 5, 1956, by duly consummated statutory merger in accordance with the Delaware General Corporation Law and Title 14 of the Revised Statutes of New Jersey. A complete and accurate copy of a Certificate of Ownership providing for such merger, dated July 3, 1956, duly filed in the office of the Secretary of State of the State of Delaware on July 5, 1956, and duly certified by said Secretary of State, is attached hereto, marked "Exhibit A", and made a part of this Complaint. A complete and accurate copy of an Agreement of Merger providing for such merger, dated July 3, 1956, duly filed in the office of the Secretary of State of the State of New Jersey, and duly certified by said Secretary of State, is attached hereto, marked "Exhibit B", and made a part of this Complaint.

7. Under said statutes, by operation of law, all property, real, personal and mixed, of each of the merging corporations, and all debts due to each of said corporations, on whatever account, and all other choses or things in action and interests belonging to either of said corporations became vested in Hertz, as the surviving corporation, upon the effectuation of said merger, including the [fol. 3] rights of Connor to file the claims for refund of tax mentioned in Paragraph 11 hereof, to make the elections set forth in said claims for refund and to recover the overpayments of taxes alleged in said claim.

8. On or about June 10, 1954, Connor duly filed its United States Corporation Income Tax Return for its fiscal year ended March 31, 1954, with the District Director of Internal Revenue in Newark, New Jersey, reporting income tax in the amount of \$18,983.13. Such tax was duly paid on or about the dates and in the amounts shown in the following table:

<i>Date</i>	<i>Amount</i>
June 10, 1954	\$ 8,547.41
September 9, 1954	\$ 8,547.41
December 2, 1954	944.16
March 4, 1955	944.15
Total	\$18,983.13

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9. On or about June 15, 1955, Connor duly filed its United States Corporation Income Tax Return for its fiscal year ended March 31, 1955 with the District Director of Internal Revenue in Newark, New Jersey, reporting income tax in the amount of \$3,894.50. Total tax for said fiscal year in the amount of \$4,644.50 was duly paid on or about the dates and in the amounts shown in the following table:

<i>Date</i>	<i>Amount</i>
June 15, 1955	\$1,947.25
September 6, 1955	1,947.25
May 10, 1956	750.00
Total	<u>\$4,644.50</u>

10. On or about June 5, 1956, Connor duly filed its United States Corporation Income Tax Return for its fiscal [fol. 4] year ended March 31, 1956, with the District Director of Internal Revenue in Newark, New Jersey, reporting income tax in the amount of \$17,550.94. Such tax was duly paid on the dates and in the amounts shown in the following table:

<i>Date</i>	<i>Amount</i>
June 5, 1956	\$ 8,775.47
September 11, 1956	8,775.47
Total	<u>\$17,550.94</u>

11. On or about September 14, 1956, there were duly filed with the District Director of Internal Revenue in Newark, New Jersey the following:

(a) a claim for refund of income tax with respect to Connor's fiscal year ended March 31, 1954, in the amount of \$100.15;

(b) a claim for refund of income tax with respect to Connor's fiscal year ended March 31, 1955, in the amount of \$4,044.54; and

(c) a claim for refund of income tax with respect to Connor's fiscal year ended March 31, 1956, in the amount of \$10,416.43.

Complete and accurate copies of said claims for refund of income taxes (omitting therefrom copies of the Certificate of Ownership and the Agreement of Merger attached thereto, copies of which are attached to this Complaint as Exhibit A and Exhibit B, respectively) are attached hereto, marked respectively, "Exhibit C", "Exhibit D" and "Exhibit E", and made a part of this Complaint.

12. No decision has been rendered on said claims for refund, and, more than six months having expired since the date of the filing of said claims, Plaintiff is now authorized to bring this suit to recover the taxes covered by said claims (Section 6532 of the Internal Revenue Code of 1954 [Section 6532, Title 26, United States Code]).

13. The income taxes of Connor for its fiscal years ended March 31, 1954, March 31, 1955, and March 31, 1956, covered by said claims for refund were erroneously and illegally collected by the District Director of Internal Revenue in Newark, New Jersey, as will more fully appear hereinafter.

14. Connor, at all times material herein, was engaged in the business of renting and leasing automobiles and trucks, without drivers, in the State of New Jersey.

15. During its fiscal years ended March 31, 1954, March 31, 1955, and March 31, 1956, Connor purchased new automobiles and trucks after December 31, 1953, for the purpose of using them in its business as described in Paragraph 14 hereof. The original use of such automobiles and trucks commenced with Connor after December 31, 1953.

16. The automobiles and trucks purchased by Connor, as aforesaid, had a useful life of three years or more.

17. On its Corporation Income Tax Returns filed for its fiscal years ended March 31, 1954, March 31, 1955, and March 31, 1956, Connor claimed the following amounts (computed as indicated) as depreciation deductions with respect to said new automobiles and trucks acquired by Connor after December 31, 1953, the original use of which vehicles commenced with Connor and commenced after such date:

[fol. 6]

Fiscal Year Ended March 31	Depreciation claimed on said automobiles	Method of computing said automobile depreciation	Depreciation claimed on said trucks	Method of computing said truck depreciation
1954	\$ 180.92	Four-year life, using rates of 30% for each of the first two years and 20% for each of the last two years; however, automobiles acquired after December 31, 1953 but prior to April 1, 1954 were depreciated at the rate of two or three cents per mile.	\$ 71.37	Five-year life for vans and heavy-duty trucks; four-year life for other trucks; however, trucks acquired after December 31, 1953 but prior to April 1, 1954 were depreciated at the rate of three cents per mile.
1955	\$14,737.34		\$3,607.78	
1956	\$46,892.12		\$5,721.99	

18. Under Section 167 of the Internal Revenue Code of 1954 (Section 167, Title 26, United States Code), Connor was entitled to depreciation deductions with respect to said automobiles and trucks for said fiscal years ended March 31, 1954, March 31, 1955, and March 31, 1956, computed on the declining balance method, using a rate of two hundred per cent (200%) of the straight-line rate, in lieu of the depreciation deductions claimed on Connor's income tax returns for said years. An election to use said declining balance method was duly made in claims for refund of income taxes, copies of which are attached hereto as Exhibits C, D and E, filed pursuant to and in accordance with Reg. 1.167(c)-1(c) of the Income Tax Regulations issued under the Internal Revenue Code of 1954 (Treasury Decision No. 6182, filed by the Division of the Federal Register on June 11, 1956).

[fol. 7] 19. On the basis of such use of two hundred per cent (200%) declining balance depreciation with respect to said vehicles, Connor's income tax was overpaid as follows:

<i>Fiscal Year ended March 31</i>	<i>Amount of overpayment</i>
1954	\$ 100.15
1955	4,044.54
1956	10,416.43,

as more fully set forth in the computations annexed to the claims for refund of income taxes, copies of which are attached hereto as Exhibits C, D and E.

20. Under Section 167 of the Internal Revenue Code of 1954 (Section 167, Title 26, United States Code), taxpayers may use two hundred per cent (200%) declining balance depreciation in the case of property with "a useful life of 3 years or more". "Useful life", as used in said statute by Congress, means the period of the normal usability of the property involved, by whomever used, hereinafter sometimes referred to as "useful physical life", and not a shorter period of actual use of such property by a specific taxpayer. However, under the Income Tax Regulations issued under Section 167 of the Internal Revenue Code of 1954 (Treasury Decision No. 6182, filed by the Division of the Federal Register on June 11, 1956), the Treasury Department has defined "useful life" to mean

"not necessarily the useful life inherent in the asset but the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income . . . determined by [among other things] the taxpayer's policy as to repairs, renewals, and replacements."

Such definition of "useful life" in said Income Tax Regulations by the Treasury Department is invalid because it [fol. 8] is contrary to the statute and the intent of Congress, and constitutes an improper attempt to exercise legislative power by the executive branch of the federal government.

21. Under Section 167 of the Internal Revenue Code of 1954 (Section 167, Title 26, United States Code), taxpayer may apply the applicable depreciation rate to the net cost (original cost less salvage value) of an asset or,

in the case of taxpayers using two hundred per cent (200%) declining balance depreciation, to the cost (without reduction for salvage value) of an asset, since such method automatically provides for salvage value. "Salvage value", as understood by Congress in enacting the depreciation provisions of the Internal Revenue Code of 1954, means the value which can be realized at the end of the useful physical life. However, "salvage value" is defined in said Income Tax Regulations as

"the amount (determined at the time of acquisition) which is estimated will be realized upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer."

Said Income Tax Regulations further provide that:

"While salvage value is not taken into account in determining the annual allowances under the declining balance method, in no event shall an asset (or an account) be depreciated below a reasonable salvage value."

Such definition of "salvage value" and such further provision with respect to accounting for salvage value under the declining balance method of depreciation, contained in said Income Tax Regulations, are invalid because they are contrary to the statute and the intent of Congress, and they constitute an improper attempt to exercise legislative power by the executive branch of the federal government.

[fol. 9] 22. Said Income Tax Regulations promulgated on June 11, 1956 may not be retroactively applied to Connor's fiscal years ended March 31, 1954, March 31, 1955 and March 31, 1956.

23. As successor by merger to Connor, Plaintiff is legally entitled to recover from defendant Federal income taxes for the fiscal years of Connor ended March 31, 1954, March 31, 1955 and March 31, 1956 in the aggregate amount of \$14,561.12, plus interest thereon as allowed by law.

Wherefore, Plaintiff asks judgment against the United States of America for the refund of income taxes for the fiscal years of J. Frank Connor, Inc. ended March 31, 1954, March 31, 1955 and March 31, 1956 in the aggregate amount of \$14,561.12, with interest thereon as allowed by law.

The Hertz Corporation (successor by merger to J. Frank Connor, Inc.), By: S. Samuel Arsht, Edwin D. Steel, Its attorneys, 3018 Du Pont Building, Wilmington, Delaware.

[fol. 10] *Duly sworn to by Walter L. Jacobs, jurat omitted in printing.*

[fol. 11]

IN UNITED STATES DISTRICT COURT

ANSWER

The defendant, by its attorney, Leonard G. Hagner, United States Attorney for the District of Delaware, answers the plaintiff's complaint as follows:

1. Defendant admits the allegations contained in Paragraph 1, except defendant denies that the taxes claimed or any portion thereof were erroneously or illegally assessed or collected.

2. Defendant admits the allegations contained in Paragraph 2.

3. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 3, and said allegations are consequently denied.

4. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 4, and said allegations are consequently denied.

5. Defendant admits the allegations contained in Paragraph 5.

6. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 6, and said allegations are consequently denied.

7. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 7, and said allegations are consequently denied.

[fol. 12] 8. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 8, and said allegations are consequently denied, except defendant admits that Connor filed a corporation income tax return for its fiscal year ended March 31, 1954, and paid the tax disclosed to be due in the amount of \$18,983.13.

9. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 9, and said allegations are consequently denied, except defendant admits that Connor filed a corporation income tax return for its fiscal year ended March 31, 1955, and paid a total tax for fiscal year 1955 in the amount of \$4,644.50.

10. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 10, and said allegations are consequently denied, except defendant admits that Connor filed a corporation income tax return for its fiscal year ended March 31, 1956, and paid the tax disclosed to be due in the amount of \$17,550.94.

11. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 11, and said allegations are consequently denied, except defendant admits that a claim for refund of income taxes with respect to Connor's fiscal

year ended March 31, 1954, in the amount of \$100.15; and a claim for refund of income taxes with respect to Connor's fiscal year ended March 31, 1955, in the amount of \$4,044.54 were filed on September 14, 1956. Defendant further admits that a claim for refund of income tax with respect to Connor's fiscal year ended March 31, 1956, in the amount of \$10,416.43 was filed on September 17, 1956. [fol. 13] Except as specifically admitted herein, defendant denies each and every allegation contained in said claims for refund.

12. Defendant admits the allegations contained in Paragraph 12.

13. Defendant denies the allegations contained in Paragraph 13.

14. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 14, and said allegations are consequently denied.

15. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 15, and said allegations are consequently denied.

16. Defendant denies the allegations contained in Paragraph 16.

17. Defendant lacks sufficient information from which to form a belief as to the truth or falsity of the allegations contained in Paragraph 17, and said allegations are consequently denied.

18. Defendant denies the allegations contained in Paragraph 18.

19. Defendant denies the allegations contained in Paragraph 19.

20. Defendant denies the allegations contained in Paragraph 20.

21. Defendant denies the allegations contained in Paragraph 21.

[fol. 14] 22. Defendant denies the allegations contained in Paragraph 22.

23. Defendant denies the allegations contained in Paragraph 23.

Wherefore, defendant, having answered fully, prays that judgment is entered dismissing plaintiff's complaint with prejudice and that defendant be awarded its costs and such other relief which to the Court may seem just and proper.

Leonard G. Hagner, United States Attorney.

SCHEDULE OF GAINS AND LOSSES FROM SALE OF VEHICLES BY J. FRANK CONNOR, INC. DURING THE FISCAL YEAR ENDED MARCH 31, 1954 (BEING AN EXHIBIT TO THE U. S. CORPORATION INCOME TAX RETURN OF J. FRANK CONNOR, INC. FOR ITS FISCAL YEAR ENDED MARCH 31, 1954, WHICH RETURN IS EXHIBIT A TO THE STIPULATION FOR FACTS HEREIN)

Description of Property	Motor #	Date Acquired mo/day/yr	Date sold mo/day/yr	Gross Sale Price	Depreciation Allowed	Expense Cost	Gain Or Loss
		Long Term Gains & Losses — Assets Held For More Than 6 Months					
Chevrolet Van	JFA384546	4/5/51	6/30/53	\$ 171.00	\$ 913.86	\$1,084.86	\$Wrecked
Chevrolet 4-Door Sedan	JAM323247	7/3/51	9/23/53		814.95	1,532.37	
Chevrolet 4-Door Sedan	JAM184355	3/25/51	9/23/53		682.92	1,533.86	(2.02)
Chevrolet Fleetline	JAM143993	2/23/51	9/23/53	2,800.00	915.55	1,515.55	
Chevrolet 4-Door Sedan	JAM323090	6/28/51	9/23/53		898.71	1,532.37	
Chevrolet Fleetline	JAM326302	6/25/51	9/28/53	1,050.00	800.62	1,529.17	321.45
Chevrolet 4-Door Sedan	JAM276032	6/24/51	9/28/53	1,100.00	957.48	1,588.70	468.78
Chevrolet Sedan	JAM519256	12/4/51	9/28/53	950.00	599.86	1,597.60	(47.74)
Chevrolet Van	GGM46084	12/14/51	9/16/53	612.00	1,242.38	1,837.54	16.84
Pontiac	L8RH18041	10/7/49	10/7/53	500.00	1,802.86	2,449.70	(146.84)
Chevrolet Sedan	JAD599146	12/27/50	10/13/53		1,038.82	1,645.00	
Chevrolet Sedan	JAM321359	6/30/51	10/13/53		851.70	1,522.37	
Chevrolet Fleetline	JAM295282	6/5/51	10/13/53		964.00	1,596.60	
Chevrolet Sedan	JAM76831	1/9/51	10/13/53	5,500.00	897.88	1,499.77	331.63
Chevrolet Sedan	JAM69071	1/5/51	10/13/53		806.24	1,499.75	
Chevrolet Fleetline	JAM408469	8/31/51	10/13/53		788.62	1,456.34	
Chevrolet Sedan	JAM321005	6/2/51	10/13/53		917.37	1,517.37	
Chevrolet Sedan	JAM321042	6/20/51	10/13/53		900.80	1,596.60	
Chevrolet Sedan	JAM521218	12/6/51	10/13/53	815.00	582.84	1,597.60	(199.76)
Chevrolet Van	FEA497474	11/8/48	10/14/53	400.00	1,569.22	1,969.22	Wrecked
Chevrolet Van	JEA794875	12/11/51	10/15/53		1,025.84	1,025.84	Wrecked
G.M.C. Walk In	B228363388	11/1/51	11/9/53	2,147.95	1,226.07	2,971.70	402.32
G.M.C. Walk In	B228363387	11/1/51	11/9/53	2,139.60	1,487.93	2,963.85	663.68
G.M.C. Walk In	B228353382	11/1/51	11/9/53	2,171.00	1,441.69	2,995.25	617.44
G.M.C. Walk In	B228357628	11/1/51	11/9/53	2,116.05	1,120.05	2,940.30	295.80
Chevrolet Sedan	JAD507761	5/2/51	12/28/53	800.00	877.65	1,681.58	(3.93)
Chevrolet Fleetline	JAM66759	1/8/51	1/12/54	650.00	804.76	1,433.66	21.10
Chevrolet 4-Door Sedan	JAD3165934	2/23/51	1/6/54	765.00	698.74	1,641.82	(178.08)
Chevrolet Sedan	JAM356235	7/19/51	2/3/54	650.00	830.02	1,552.90	(72.88)
Chevrolet Fleetline	JAM276091	6/5/51	2/3/54	650.00	897.28	1,529.17	18.11
Chevrolet Fleetline	JAM518948	12/10/51	2/3/54	550.00	686.30	1,631.61	(395.31)
Chevrolet Sedan	JAM337934	7/5/51	3/5/54	630.00	857.90	1,532.37	(44.47)
Chevrolet Sedan	JAM24814	5/8/51	3/8/54	675.00	942.02	1,520.74	96.28
Chevrolet Sedan	JAM525282	12/6/51	3/8/54	725.00	719.74	1,597.60	(152.86)
Chevrolet Sedan	JAM515555	12/4/51	3/19/54	650.00	609.12	1,606.35	(347.23)
Station Wagon	88PB46611	8/4/48	3/15/54	300.00	2,485.73	2,954.25	(168.52)
TOTALS				\$29,517.60	\$35,657.52	\$63,681.33	\$1,493.79

GAINS AND LOSSES FROM VEHICLE SALES, YEAR ENDED 3/31/54 15b

[fol. 15]

SCHEDULE OF GAINS AND LOSSES FROM SALE OF VEHICLES BY J. FRANK CONNOR, INC. DURING THE FISCAL YEAR ENDED MARCH 31, 1955 (BEING AN EXHIBIT TO THE U. S. CORPORATION INCOME TAX RETURN OF J. FRANK CONNOR, INC. FOR ITS FISCAL YEAR ENDED MARCH 31, 1955, WHICH RETURN IS EXHIBIT B TO THE STIPULATION OF FACTS HEREIN)

Description Of Property	Motor No.	Date Acquired Mo-Day-Yr	Date Sold Mo-Day-Yr	Gross Sales Price	Depreciation Allowed	Cost Or Other Basis	Gain Or (Loss)
Chev. Sedan	JAM294393	4-16-51	4-25-54	675.00	933.70	1,520.74	87.96
Chev. Coupe	JAD183170	12-10-51	4-2-54	725.00	654.86	1,799.22	(419.36)
Chev. Station Wagon	JAM12319	1-19-51	4-2-54	750.00	1,455.18	1,943.70	251.48
Chev. Sedan	KAM 148612	5-26-52	4-30-54	900.00	778.76	1,700.28	(21.52)
Chev. Sedan	KAM 130930	5-26-52	4-29-54	900.00	807.14	1,646.98	60.16
Chev. Sedan	KAM147475	5-26-52	4-29-54	850.00	595.22	1,782.28	(337.06)
Pontiac Sedan	P6US20640	9-17-51	6-11-54	1,000.13	787.74	1,866.05	(78.18)
Chev. Station Wagon	JAM317000	6-19-51	7-8-54	500.00	1,308.16	1,953.31	(145.15)
Chev. Van	HEA 755644	7-7-50	7-7-54	1,088.25	2,033.40	2,934.08	107.57
Chev. Van	HEA755625	7-7-50	7-7-54	1,088.25	2,030.10	2,934.08	104.27
Chev. Sedan	KAM232649	9-24-52	12-9-54	870.00	763.37	1,834.46	(201.09)
Chev. Sedan	KAM216648	9-16-52	12-8-54	844.00	679.63	1,776.88	(253.25)
Chev. Coupe	JAD882711	9-31-51	12-28-54	677.00	919.12	1,652.54	(56.42)
Chev. Coupe	HEA964131	8-23-50	12-30-54	450.00	1,355.69	1,805.69	Wrecked
Chev. Van	KEM67058	5-12-52	1-31-55	2,450.86	1,455.55	3,039.11	867.30
Chev. Van	HEA1306609	11-21-50	2-17-55	722.00	1,268.89	2,110.70	(119.81)
Chev. Sedan	KAM261742	10-15-52	2-5-55	550.00	890.46	1,440.46	Wrecked
Chev. Sedan	KAM294695	9-10-53	2-4-55	858.00	846.33	1,776.88	(72.55)
Totals				25,799.49	19,558.30	35,517.44	(225.65)

SCHEDULE OF GAINS AND LOSSES FROM SALE OF VEHICLES BY J. FRANK CONNOR, INC. DURING THE FISCAL YEAR ENDED MARCH 31, 1955 (BEING AN EXHIBIT TO THE U. S. CORPORATION INCOME TAX RETURN OF J. FRANK CONNOR, INC. FOR ITS FISCAL YEAR ENDED MARCH 31, 1955, WHICH IS EXHIBIT C TO THE STIPULATION OF FACTS HEREIN)

14
16b GAINS AND LOSSES FROM VEHICLE SALES, YEAR
ENDED 3/31/55 [fol. 16]

Chev. Sedan

KAMAZ2020

2-10-52

2-10-52

2-10-52

Totals

15,788.49

19,553.30

35,517.44

(225.05)

SCHEDULE OF GAINS AND LOSSES FROM SALE OF VEHICLES BY J. FRANK CONNOR, INC. DURING THE FISCAL YEAR ENDED MARCH 31, 1956 (BEING AN EXHIBIT TO THE U. S. CORPORATION INCOME TAX RETURN OF J. FRANK CONNOR, INC. FOR ITS FISCAL YEAR ENDED MARCH 31, 1956, WHICH IS EXHIBIT C TO THE STIPULATION OF FACTS HEREIN)

Kind of Property	Date acquired	Date sold	Gross sales price (contract price)	Depreciation allowed (or allowable)	Cost or other basis	State gain or (loss)
Chev. Sd.	10-15-52	4-19-55	\$ 600.00	\$ 772.10	1,881.19	(509.09)
Chev. Sd.	2-10-53	4-20-55	775.00	877.27	1,921.58	(269.31)
Chev. Sd.	3-18-53	4-20-55	800.00	803.42	1,797.99	(194.57)
Chev. Sd.	5-1-53	4-20-55	775.00	793.38	1,798.79	(230.41)
Chev. Sd.	5-2-53	4-20-55	775.00	830.30	1,801.23	(195.93)
Chev. Sd.	6-16-53	4-20-55	800.00	868.39	1,788.72	(120.33)
Chev. Sd.	1-26-53	4-20-55	850.00	825.75	1,796.82	(121.07)
Ford Truck	3-30-48	4-25-55	637.21	1,450.39	2,067.65	19.95
Chev. Sd.	7-23-53	5-25-55	750.00	801.25	1,840.19	(288.94)
Chev. Sd.	7-17-53	5-23-55	975.00	876.23	2,067.89	(216.66)
Chev. Sd.	4-22-53	5-24-55	775.00	865.19	1,801.04	(160.85)
Chev. Sd.	4-3-53	5-26-55	775.00	922.27	1,795.76	(98.49)
Chev. Sd.	4-10-53	5-26-55	775.00	878.08	1,795.76	(142.68)
G.M.C. Van	7-8-54	5-16-55	2,852.37	390.00	2,633.54	608.83
G.M.C. Van	7-8-54	5-16-55	2,883.60	390.00	2,631.65	641.95
G.M.C. Van	7-8-54	5-16-55	2,904.42	417.00	2,814.65	506.77
Chev. Sd.	9-28-53	5-31-55	800.00	727.16	2,079.82	(552.66)
Chev. Sd.	9-21-53	5-31-55	825.00	804.72	1,831.38	(201.66)
Chev. S/W	1-31-52	6-14-55	800.00	1,512.14	2,243.41	68.73
Pontiac Sd.	4-1-53	6-29-55	1,354.71	757.96	2,348.07	(235.40)

GAINS AND LOSSES FROM VEHICLE SALES, YEAR 17b
ENDED 3/31/56

[10.17]

SCHEDULE OF GAINS AND LOSSES FROM SALE OF VEHICLES BY J. FRANK CONNOR, INC. DURING THE FISCAL YEAR ENDED MARCH 31, 1956, CONT'D

Kind of Property	Date acquired	Date sold	Gross sales price (contract price)	Depreciation allowed (or allowable)	Cost or other basis	State gain or (loss)
			\$	\$	\$	\$
Chev. Sd.	4-23-53	6-17-55	775.00	658.88	1,798.85	(364.97)
Chev. Sd.	6-9-53	6-28-55	785.00	836.30	1,799.85	(178.55)
Oldsmobile Sd.	3-28-51	6-29-55	1,029.21	2,003.38	3,028.50	4.09
Chev. Sd.	9-28-53	6-28-55	845.00	824.97	2,101.67	(431.70)
Chev. Sd.	9-21-53	6-28-55	860.00	724.93	1,797.22	(212.29)
Chev. Sd.	6-29-53	6-17-55	775.00	857.61	1,799.77	(167.16)
Chev. Sd.	7-14-53	6-20-55	800.00	721.51	1,962.71	(441.20)
Chev. Sd.	7-7-53	6-28-55	775.00	720.25	1,798.36	(303.11)
Chev. Sd.	7-27-53	6-28-55	825.00	685.05	1,975.81	(465.73)
Chev. Sd.	7-14-53	6-21-55	800.00	875.48	1,965.59	(290.11)
Chev. Sd.	7-21-53	6-21-55	750.00	769.47	1,802.97	(283.50)
Chev. Sd.	4-1-53	6-21-55	750.00	846.48	1,799.07	(202.59)
Chev. Sd.	7-13-53	7-7-55	750.00	669.54	1,801.04	(381.50)
Chev. Sd.	3-26-53	7-5-55	845.00	1,150.00	1,966.17	28.83
Chev. Sd.	6-15-53	7-8-55	750.00	716.66	1,792.20	(325.54)
Chev. Sd.	7-7-53	7-7-55	775.00	837.81	1,797.22	(184.41)
Chev. Pick Up	10-31-51	8-12-55	100.00	1,257.96	1,357.96	—
Ford Van	7-10-49	8-22-55	300.00	1,678.61	1,950.43	28.18
Chev. Van	9-26-50	8-22-55	420.00	2,515.00	2,765.00	170.00
Chev. Pick Up	5-27-52	9-29-55	425.00	1,077.38	1,448.22	54.16

SCHEDULE OF GAINS AND LOSSES FROM SALE OF VEHICLES BY J. FRANK CONNOR, INC. DURING THE FISCAL YEAR ENDED MARCH 31, 1956, CONT'D

18b GAINS AND LOSSES FROM VEHICLE SALES, YEAR ENDED 3/31/56

Chev. Pick Up 5-27-52 9-29-55 425.00 1,077.38 1,448.22 54.16

SCHEDULE OF GAINS AND LOSSES FROM SALE OF VEHICLES BY J. FRANK CONNOR, INC. DURING THE FISCAL YEAR ENDED MARCH 31, 1956, CONT'D

Kind of Property	Date acquired	Date sold	Gross sales price (contract price)	Depreciation allowed (or allowable)	Cost or other basis	State gain or (loss)
			\$	\$	\$	\$
Chev. Sd.	4-2-54	10-12-55	1,100.00	810.00	1,881.49	28.51
Chev. Sd.	3-8-54	10-1-55	1,100.00	824.06	1,881.49	42.57
Chev. Sd.	4-2-54	11-1-55	1,100.00	810.00	1,881.49	28.51
Chev. Sd.	4-1-53	11-1-55	700.00	931.05	1,743.35	(112.30)
Chev. Sd.	2-23-54	11-2-55	1,000.00	774.14	1,881.49	(107.35)
Chev. Sd.	5-14-54	11-7-55	900.00	765.00	1,698.62	(33.62)
Chev. Sd.	3-15-54	11-15-55	1,000.00	831.30	1,925.00	(93.70)
Chev. Sd.	6-21-54	11-15-55	965.00	765.00	1,877.25	(147.25)
Chev. Sd.	3-8-54	11-21-55	900.00	698.30	1,725.14	(126.84)
Chev. Sd.	4-54	11-29-55	900.00	855.00	1,846.72	(91.72)
Chev. Sd.	4-2-54	11-29-55	900.00	900.00	1,881.49	(81.49)
Chev. Sd.	4-29-55	11-29-55	935.00	855.00	1,856.79	(66.79)
Chev. Sd.	7-2-54	11-29-55	1,000.00	782.00	1,852.25	(70.25)
Chev. Sd.	3-15-54	12-1-55	850.00	958.45	1,763.00	45.45
Chev. Sd.	6-22-55	12-5-55	275.00	240.00	515.00	—
Chev. Sd.	4-29-54	12-6-55	900.00	900.00	1,846.72	(46.72)
Ford Sd.	6-2-54	12-6-55	900.00	760.00	1,704.00	(44.00)
Chev. Van	1-25-52	12-16-55	350.00	1,685.38	2,035.38	—
Chev. Sd.	5-10-54	12-21-55	905.00	900.00	1,838.14	(33.14)
Chev. Sd.	12-28-53	12-21-55	950.00	763.15	1,881.49	(168.34)
Chev. Sd.	5-12-54	12-27-55	900.00	900.00	1,838.14	(38.14)

[fol. 19]

GAINS AND LOSSES FROM VEHICLE SALES, YEAR 19b
ENDED 3/31/56

SCHEDULE OF GAINS AND LOSSES FROM SALE OF VEHICLES BY J. FRANK CONNOR, INC. DURING THE FISCAL YEAR ENDED MARCH 31, 1955, CONT'D

Kind of Property	Date acquired	Date sold	Gross sales price (contract price)	Depreciation allowed (or allowable)	Cost or other basis	State gain or (loss)
			\$	\$	\$	\$
Chev. Sd.	2-3-54	12-27-55	915.00	893.21	1,725.14	83.07
Ford Sd.	6-7-54	12-28-55	815.00	855.00	1,886.62	(216.62)
Chev. Sd.	1-6-54	12-29-55	965.00	748.62	1,881.49	(167.87)
Chev. Sd.	7-2-54	1-5-56	900.00	798.00	1,690.04	7.96
Chev. Sd.	7-8-54	1-13-56	900.00	774.00	1,700.00	(26.00)
Chev. Sd.	5-12-55	1-13-56	400.003	343.00	743.00	—
Ford Sd.	7-15-54	1-18-56	775.00	875.00	1,864.98	(214.98)
Chev. Sd.	7-2-54	1-18-56	900.00	817.00	1,713.42	3.58
Chev. S/W	6-23-53	1-25-56	745.00	1,422.23	2,057.13	110.10
Chev. Sd.	6-17-54	1-23-56	960.00	855.00	1,877.25	(62.25)
Chev. Sd.	2-3-54	1-19-56	905.00	788.80	1,725.14	(31.34)
Chev. Sd.	7-2-54	1-27-56	945.00	893.00	1,838.14	(.14)
Chev. Sd.	3-19-54	1-27-56	925.00	771.63	1,892.64	(196.01)
Chev. Sd.	9-29-50	2-14-56	300.00	1,638.70	1,898.70	50.00
Chev. Van	10-25-50	2-14-56	275.00	1,510.20	1,760.20	25.00
Olds. Sd.	7-8-54	2-14-56	1,200.22	1,026.00	2,622.13	(395.91)
Olds. Sd.	6-15-54	2-14-56	1,200.22	1,056.00	2,622.13	(365.91)
Pontiac S/W	3-27-53	2-27-56	2,206.78	1,725.13	2,861.68	1,070.23
Totals				\$	\$	\$
			<u>71,378.74</u>	<u>72,498.65</u>	<u>150,960.01</u>	<u>(7,082.62)</u>

20b GAINS AND LOSSES FROM VEHICLE SALES, YEAR ENDED 3/31/56

[fol. 20]

[fol. 21] Fiscal Y
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IN UNITED STATES DISTRICT COURT

PLAINTIFF'S EXHIBIT 1

Fiscal Year Ended March 31	Depreciation claimed on said automobiles	Method of computing said automobile depreciation	Depreciation claimed on said trucks	Method of computing said truck depreciation
1954	\$ 180.92	Four-year life, using rates of 30% for each of the first two years and 20% for each of the last two years;	\$ 71.37	Five-year life for vans and heavy-duty trucks;
1955	\$14,737.34	however, trucks acquired after December 31, 1953 but prior to April 1, 1954 were de- preciated at the rate of three cents per mile.	\$3,607.78	four-year life for other trucks;
1956	\$46,892.12	however, auto- mobiles acquired after December 31, 1953 but prior to April 1, 1954 were depreciated at the rate of two or three cents per mile.	\$5,721.99	however, trucks acquired after December 31, 1953 but prior to April 1, 1954 were de- preciated at the rate of three cents per mile.

[fol. 22]

IN UNITED STATES DISTRICT COURT

EXCERPTS FROM TRANSCRIPT OF TESTIMONY OF APRIL 16, 1958

COLLOQUY

Mr. Arsht: If your Honor please, this is the time fixed for the trial of The Hertz Corporation versus United States, Civil Action No. 1921. At the pre-trial conference on April 10th I did present and your Honor admitted Mr. Edgar Bernhard and Mr. Donald J. Yellon of the Chicago Bar, and I would like to formally move their admission at this time pro hac vice, and also I would like to move the admission pro hac vice of Mr. John C. Klett, Jr. of the New York Bar whom your Honor did not meet at the pre-trial conference.

The Court: Gentlemen, you are admitted with pleasure pro hac vice.

Mr. Arsht: Mr. Bernhard will be chief counsel for the plaintiff.

Mr. Hagner: May it please the Court, I should like to move the admission pro hac vice of Mr. Anthony DeSanto, whom I am sure you remember from last week, and Mr. Gerald J. O'Brien of the Department of Justice, whose admission I should like to move at this time.

The Court: Gentlemen, you are both admitted with pleasure pro hac vice.

All right, Mr. Bernard.

Mr. Bernhard: Your Honor, may I hand up to the Court the stipulation which we have worked out on at least a portion of the routine matters. I think all of the routine matters at least are contained in that stipulation and I think also that that ought to save considerable of the Court's time.

Your Honor, this is a suit for refund of income taxes which we say were overpaid for the fiscal years ending [fol. 23] March 31, 1954, 1955, and 1956. It is agreed that in July, 1956, Connor was merged into The Hertz Corporation and that Hertz succeeded to Connor's rights and is, therefore, the proper plaintiff in this case. Connor was in the rent-a-car business. Connor filed its income tax returns for those three years in question, taking depreciation of its automobiles on the basis of a four-year life and taking 30 per cent each of the first two years and 20 per cent the third and fourth years, a 30-30-20-20 per cent depreciation. However, in the claims for refund as filed the taxpayer, it is agreed, properly made its election to take depreciation on the declining balance method, using 200 per cent of the straight-line depreciation method. This method of depreciation is open to us, we say, because the 1954 Code provides that this form of accelerated depreciation can be applied to assets with a useful life of three years or more, and we expect to show your Honor that the useful life of these automobiles has been very consistently and properly defined as the business life of an asset not just in the hands of the taxpayer, but the business life of an asset in the

hands of a taxpayer and other owners making a business use of that asset, and that the useful life of the asset does not suddenly come to an end upon its sale after a year a year and a half or any other period within its potential useful business life, and that business life and economic life of an automobile is four years, we say.

We further expect to show that the sole basis for the Government's position here is a Treasury Department Regulation which the Government is not only trying to apply retroactively, but which we say does not apply because it does not implement the depreciation provisions in the 1954 Code or facilitate their administration or clarify them, but on the contrary contradicts the purpose and intention of Congress in passing the 1954 Code. By that regulation we say the Treasury Department is really at-[fol. 24] tempting to say that you must go to straight line depreciation or some method other than the 200 per cent declining balance method, and we say that such a regulation is a nullity.

The Court: May I interrupt? You mean they are attempting to say that in the case, unless you can show conclusively that your particular machines had a useful life of more than three years, because then to comply with the regulation you would have no trouble.

Mr. Bernhard: That is right. We are saying that their basis for their position here at all is a regulation which goes contrary to the 1954 Code among other things, because in 1953 and 1954 Congress was faced with an economic situation which, by the way, was very similar to the current 1957-1958 situation, and declared itself in favor of a policy which would encourage capital investment, and to that end rejected proposals that would eliminate or discourage or diminish capital investment, capital gains, and it enacted into law incentives for greater capital investment, for making capital investment attractive, to encourage additional production, to maintain in that way an increased employment and payment of wages and the purchase of consumer goods and the investment of additional capital.

The Treasury Department is really attempting, we say, to impose a new definition of "useful life" by regulation,

and any such regulation contrary to the enactments and purposes of Congress we say is a nullity. The automobiles in question here we expect to show had a four-year life, and the 200 per cent declining balance method is open to us, and we were therefore entitled to make the election and adopt that method, and that we are therefore entitled to the refund of income taxes overpaid for that period. [fol. 25] Mr. De Santo: May it please the Court, the Government's position in this case we don't think is too difficult to understand. We think that implicit in the regulations for a great many years prior to the adoption of the 1954 Code was a concept of useful life that was pretty much equivalent to what might better be described as depreciable life; that in arriving at the useful life of any particular asset you did not blind yourself to the economic realities of the particular taxpayer. The regulations did not require that. It may be true that under the straight line methods of depreciation then popular, or other variation, that a situation arose where the physical life of the asset and its usefulness to the particular taxpayer in many respects—perhaps in the majority of the cases—coincided. But we don't believe it follows from that that the regulations required that that was the only method or only factor to take into consideration in determining the useful life, the physical life of the asset as an abstract concept regardless of who uses it and what use they make of it and what the realities of their own business in regard to that particular asset are.

We submit that the 1954 regulations or the regulations promulgated under the 1954 Code do emphasize, as the regulations under the 1939 Code did not emphasize, perhaps, these other factors, but we do not think that a shift in emphasis or a necessity to apply concepts that remained dormant, but nonetheless existed over a period of years, means that a radical change in substance of a legislative character occurred by virtue of the adoption of these particular concepts in the regulations under the 1954 Code. We think and believe that the regulations under the 1954 Code provide—and particularly the definition of useful life—provide a definition that is most consistent with the purpose of Congress in enacting this legislation. We be-

lieve that when Congress picked up this term "useful life" and put it in the statute as a limitation upon the [fol. 26] right of any taxpayer to use the declining balance method it picked up a concept that had for its proper application two important concepts: One is of course the physical life of the asset, the wear and tear. The statute has always said wear and tear plus obsolescence. Now, that particular factor of obsolescence, as well as the particular factor of wear and tear, can vary with the individual taxpayer. In fact, I find it impossible to conceive of a situation where an asset would have but one life regardless of the use to which it is put, regardless of the economic realities of the business of the particular taxpayer; and we don't believe that Congress had that in mind either. We think when they put that limitation of three years into the Code they were thinking of this concept of useful life whereby you would consider what the useful life would be to the particular taxpayer, taking these two factors into consideration, and if that useful life were less than three years, then they would not be permitted to use the declining balance method.

The Court: Would you say that just once again, please?

Mr. De Santo: I say that when Congress picked up this concept of useful life it was thinking in terms of the useful life to the particular taxpayer.

The Court: Not this business of passing on by selling? That is why your regulation, you say, reflects the intention of Congress—the three-year provision reflects, as you say, the intent of Congress.

Mr. De Santo: That is right, your Honor.

The Court: All right.

Mr. De Santo: We think that is basic in putting in the three-year limitation at all. We think that Congress obviously put the three-year limitation in to make certain that the write-off of the automobile or other asset would not be so ridiculously fast as to lead to unreasonable gains rather than a recovery of cost.

[fol. 27] The Court: This statute was not just directed at the automobile leasing business?

Mr. De Santo: No, sir. I said or any other asset. In other words, our point is that Congress did not intend to

change in passing the 1954 Code any of the basic fundamental concepts of depreciation that it has put there to enable you to recover your cost over the period of time you are going to get your use out of it, less selling.

The Court: My understanding is that the only difference between you and the Hertz people here is whether or not it can sell its cars in less than three years but still claim that the cars have a useful life of three or more years under that provision of the statute.

Mr. De Santo: To put it another way, your Honor, whether or not it can have an experience of usefulness wherein it uses its automobiles for periods of less than three years, but still can come along and claim that there is a useful life of more than three years.

The Court: All you are doing is relating that experience to the original owner of the car. In other words, you are saying that that owner can't pass on the car to another owner. Even though the car might have a useful life of more than three years you are contending, are you not, that that must be three years to the original owner of that car, or aren't you?

Mr. De Santo: Well, the assumption in your question is pretty much a conclusion with respect to the issue in this case, your Honor.

The Court: I didn't mean it to be.

Mr. De Santo: We say "useful life" is defined under the regulation. It means the period of usefulness to the particular taxpayer. That is what "useful life" means. [fol. 28] The factors that go into that determination of the physical wear and tear, considering the nature of the taxpayer's business and economic aspects of whether the organization can use a car for more than three years in its business, considering the competitive nature of the business. These are two things: One is physical life, the other is normal obsolescence; but the two go into determining what useful life is.

So obviously if this taxpayer has an average period of usefulness of an asset of less than three years and his experience shows that, then we say that is his useful life and it is not a question of passing on more life to somebody else. He is passing on service life to somebody else,

but the concept of useful life under the depreciation provision is not necessarily coincident with that service life.

Another issue in this case which the Court will only reach should it decide the Government's regulations are in error or are in conflict with the statute is the issue with respect to whether if the taxpayers are entitled to use the physical life, nonetheless their recovery must be limited—the total depreciation they can take even under the declining balance method must be limited by the salvage value of the particular asset. So that creates a problem with respect to salvage value.

Now, "salvage value" as defined in the regulations means in simple language what the taxpayer who uses the automobile can expect to recover for it when he gets rid of it. What can he get for it? What is the value? Under the declining balance method under the regulations you do not take this estimated salvage value and reduce the basis of the automobile when you get it. The regulations do not require that type of an adjustment. What the regulations do provide, however, is that you take the entire cost or other basis and you then apply the declining balance rate to that basis, but you will allow in recovery by application of that rate an amount less this salvage value, as I have indicated it is defined under the regulations.

The Court: Give me an example of what you mean by that.

Mr. De Santo: Assume an automobile were worth \$2,000 or the cost of the automobile was \$2,000. Assume also that under the regulations and based on the taxpayer's experience his estimated salvage value was seven or eight hundred dollars for that automobile, and assume again that he was entitled to use the declining balance method of depreciation. Then assume at the end of let us say two years he sold that particular automobile. In the first year by using the declining balance method on a four year straight life he would be entitled to use a rate of double the normal uniform straight line method, which would be 50 per cent for the first year. That would give him a recovery of \$1,000 in the first year. In the second year he would again apply that constant rate of 50 per

cent to the remaining balance of \$1,000 and would recover \$500. At the end of the second year he has sold this automobile, and let us assume he sold it for \$500. This \$500 would represent salvage value.

I think my illustration is bad for one reason, your Honor. Let us assume he kept it three years. If he had kept it three years, in the third year his estimated salvage value of \$500—he would have reached that—in the third year even though he retained the automobile he would be entitled to no depreciation because he had reached his salvage value. So I think that is a clear illustration.

The Court. He would be down to \$250?

Mr. De Santo: He would not get the \$250, your Honor, because under the Commissioner's regulations he could only go down to what the estimated salvage value was. In this [fol. 30] particular case it would be \$500 and no more depreciation would be permitted.

I say you reach that problem only if you decide the first issue adversely to the Government.

With regard to whether the regulations were retroactive or not, that in turn, of course, depends a great deal on the disposition of the first—whether they can be applied retroactively depends a good deal on the disposition of the first issue and the conclusion of this Court thereon. If there was any radical change of a legislative character certainly the Commissioner's regulations can be applied retroactively at least until the date of the statute when it was promulgated. If they did effect a legislative change of such extreme character that they are in conflict with the statute, then I don't think we have reached the question of retroactivity, because your decision would then dispose of that question. If they are in conflict and invalid you don't reach that.

That, in short, your Honor, is the Government's position in this case.

Mr. Bernhard: Your Honor, I don't propose to add argument, but for the sake of clarity I think I ought to say this about salvage, since I didn't mention it, because we consider it no part of this case. We are on the 200 per cent declining balance method and therefore we say salvage is already built in in a sense. It has been referred to as

built in since you never fully depreciate. Since you are always taking a percentage of a declining balance, you never reach 100 per cent; so therefore they say your salvage value is built in.

Mr. De Santo: Your Honor, we will invoke the rule, if plaintiff intends to call more than one witness, as to separation.

The Court: All right.

[fol. 31] Mr. Bernhard: I take it, your Honor, if the witnesses are to be excluded one representative of the corporation can stay in the courtroom, even though he is to be called as a witness—one representative of the plaintiff?

Mr. De Santo: We have no objection to that.

Mr. Bernhard: Do you want all other witnesses excluded?

Mr. De Santo: Yes.

(At this point several people left the courtroom.)

PLAINTIFF'S EVIDENCE

PAUL F. JOHNSON, called as a witness on behalf of the plaintiff, having been duly sworn, testified as follows:

Direct Examination.

By Mr. Bernhard:

Q. Would you state your full name, please, Mr. Johnson?

A. Paul F. Johnson.

Q. What is your business or profession?

A. I am a partner in the firm of Ernst & Ernst, certified public accountants.

Q. How long have you been connected with Ernst & Ernst?

A. Since July of 1930.

Q. Would you give us just a resume of your educational qualifications and your experience?

A. I graduated from the University of Illinois in June of 1930, majoring in accounting. I joined the Chicago

office of Ernst & Ernst in July of 1930. I have been in charge of the tax practice in our Chicago-office since 1942. I have been a partner in the firm since 1946.

Q. Are you authorized to represent taxpayers before the Treasury Department?

A. Yes, sir.

[fol. 32] Q. Have you so represented clients?

A. Yes, sir.

Q. Is there a definition of "useful life" in the 1954 Code, Mr. Johnson?

A. No, sir, there is not.

Q. In your experience as a certified public accountant what is the meaning of the term "useful life" in connection with the taking of depreciation?

Mr. De Santó: We object to that question, your Honor. The definition of the term "useful life" is before this Court. This Court is to decide that as a question of law, and we don't need Mr. Johnson's testimony.

The Court: I am afraid I will overrule you on that. I think I want to hear that. You may answer that question.

A. Over the years useful life in its application as I have seen it has been applied as the business life of an asset regardless of whether it passed from one owner to another. In other words, useful life was meant to be the total life for which the asset was useful for business purposes.

I would like to add to that that since the promulgation of the regulations under the 1954 Code in 1956 we have had some instances where the Revenue Agents have insisted upon the application of that regulation.

By Mr. Bernhard:

Q. Prior to the promulgation of the 1956 regulations what was your experience with representatives of the Treasury Department, of the Internal Revenue Service?

A. It was always the depreciation rate was computed on the basis of the aggregate business life regardless of the ownership of the asset.

[fol. 33] Q. In your accounting practice do you find that there is an accepted practice followed by business users of automobiles as to the number of months or years taken as the useful life of automobiles?

A. Well, I think over the years quite generally the useful life taken by taxpayers has been four years. There, of course, are some variations, some shorter and some longer, but four years I would say is a rather general period of useful life used.

By the Court:

Q. That has still to do with this particular kind of business or is this a general answer?

A. That would be a general answer, sir.

By Mr. Bernhard:

Q. That is, you are referring to users of automobiles for business purposes?

A. Yes, sir, users of automobiles.

Q. For business purposes?

A. Yes, but not specifically lessors.

Q. But I take it you are not excluding lessors of automobiles, since they are users of automobiles for business purposes?

A. No, sir, I am not.

Q. Is what you have just said equally true if the taxpayer itself holds and uses the automobile for less than four years?

A. Yes, that has been generally true, with the exception that I noted before that since the promulgation of the regulations in 1956 there have been some changes in application by Revenue Agents.

Mr. Bernhard: That is all.

[fol. 34] Cross Examination.

By Mr. De Sanfo:

Q. Mr. Johnson, just a few questions. You, of course, in your experience—can you say you have never had a sit-

uation arise where what you call the business life did not vary with a particular taxpayer of an automobile?

A. I am not sure I understand your question, sir.

Q. Can you say that the business life of an asset—you say business life and you said generally four years?

A. Yes.

Q. I take it by your use of the term "generally" there are instances in which there may be less than four years or maybe more than four years?

A. Yes.

Q. Why is it that sometimes it will be less than four years and sometimes more than four years? What factors in your experience have you come across in that type of case that have been considered, sir?

A. I think it would be generally the intensive use of the automobile.

Q. Intensive use? Because more miles are put on it?

A. That would certainly be a factor.

Q. You state, I believe, that this was always true under the 1939 Code, that you never had trouble with the Internal Revenue Service in using that method prior to the regulations under the 1954 Code?

A. What do you mean by "that method", sir?

Q. The method of depreciating an automobile on the basis of its physical life?

A. To my best recollection that is true.

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[fol. 35] RAYMOND A. HOFFMAN, called as a witness on behalf of the plaintiff, having been duly sworn, testified as follows:

Direct Examination.

By Mr. Bernhard:

Q. Your full name, Mr. Hoffman?

A. Raymond A. Hoffman.

Q. What is your profession?

A. I am a certified public accountant.

Q. With whom are you associated?

A. Price, Waterhouse & Company.

Q. In what capacity?

A. I am a partner in the firm and have been a partner since 1951.

Q. How long have you been connected with Price, Waterhouse?

A. Since 1934.

Q. Can you give us just an outline of your educational qualifications and experience?

A. I have a Bachelor of Science Degree with major in accounting from the College of Commerce and Business Administration at the University of Illinois. I also have a Master's Degree from that school. I am a C.P.A., certified public accountant, being licensed in New York, Ohio, Illinois, and several other states.

Q. Does your work include tax work and tax problems in connection with Price, Waterhouse?

A. Yes. I started on what we call the audit staff in the firm as a junior accountant, and for the past twenty years or a little more practically all of my time has been given to Federal income tax matters.

[fol. 36] Q. I take it you are authorized to represent clients before the Treasury Department?

A. Yes, I am.

Q. And you do so represent clients?

A. Yes.

Q. Mr. Hoffman, in your experience as a certified public accountant what is the meaning of the term "useful life" in connection with the taking of depreciation?

Mr. De Santo: I object to that, your Honor. He is asking what the meaning of "useful life" is, and I think that is just as much a legal conclusion.

The Court: Well, we passed on something very close to that a minute ago. I think the question was couched in slightly different language. I will overrule you. What his impression is by the use of that term in the accounting business, I would permit a question along that general line.

(The last question was read by the Reporter.)

The Court: I will overrule the objection. You may answer.

A. In the computation of depreciation the practice has been both for general financial statement presentation, books of account, and Federal income tax returns to compute the depreciation by applying a percentage to the gross cost of the asset on the basis of its estimated business life, which would be the useful life in this particular connotation.

By the Court:

Q. That does not quite answer the question. That is the practice, but what is "useful life"? That is what the question is.

A. The business life of that class of asset.

By Mr. Bernhard:

Q. In your answer are you limiting the business life as you defined it to the period that a particular taxpayer uses the asset in his particular business or not?

[fol. 37] A. No, it would be the business life inherent in that class of property, and the fact that it might be re-sold would be immaterial to the matter of useful life in business life.

Q. In dealing with representatives of the Internal Revenue Service what is the meaning given by them to the term "useful life"?

Mr. De Santo: I object to that, your Honor. We have Bulletin F here which will speak for itself.

Mr. Bernhard: That is one pronouncement of the Commissioner of Internal Revenue, but I am talking about this man's experience with representatives of the Treasury Department and of the Internal Revenue Service and what they consider to be useful life and whether it matches with his definition of useful life and the general definition.

Mr. De Santo: I might add, your Honor, that I don't see where he is qualified to speak or give any opinion as to what the Internal Revenue Service's position is. He is not affiliated with the Internal Revenue Service at all and never has been.

The Court: I would suppose as to that phase of the objection he could either say he is not familiar or he has

no dealings with the representatives of the Bureau, so I am not so concerned about that as I am with the first part of your objection, which is it is what is represented by the bulletin.

I will overrule your objection at this time. I will certainly keep in mind your objection. No prejudice will result from it.

Answer the question.

A. Traditionally the attitude of Internal Revenue Agents in this matter of depreciation and useful life has been consistent with the general accounting concept of useful [fol. 38] life as being the business life inherent in the asset.

By the Court:

Q. Is that true since 1956?

A. There has been a change, because since the issuance of the recent regulations starting in 1956 the agents are raising the question about a different concept now being applicable in this matter of useful life.

By Mr. Bernhard:

Q. In your experience do you find an accepted practice followed by business users of automobiles as to the number of months or years taken as the useful life of such automobiles?

A. There is no completely uniform practice. In certain cases the depreciation may be computed on the basis of a three-year life or $33\frac{1}{3}$ per cent per annum. In other cases it may be 20 per cent depreciation rate or on a five-year useful life. But the great majority of cases and the great weight is in favor of a four-year life, which is about the average between the three and the five.

Q. Mr. Hoffman, is that equally true if the taxpayer itself holds and uses the car for a period that is less than four years or less than the life taken?

A. Yes. Business generally where they are using a 25 per cent depreciation rate will not always hold the asset themselves for the full four years.

Q. But you are saying it is equally true even in those cases?

A. That is right, yes.

Mr. Bernhard: That is all.

Cross examination.

By Mr. De Santo:

Q. Sir, I hand you this Bulletin F and ask you if this is what you are referring to when you answered counsel's question regarding that?

[fol. 39] A. Not exactly. I was basing my answer to the question on the basis of my experience in dealing with Internal Revenue Agents in the field and representatives of the valuation section.

Q. You have never seen Bulletin F?

A. I have seen Bulletin F and I am quite familiar with Bulletin F yes.

Q. Wasn't the question really what their attitude was under Bulletin F?

A. I understood the question to be based on my experience and contacts and procedures.

Q. Wasn't it limited to what your experience was under Bulletin F?

A. This experience has been under Bulletin F, yes, because Bulletin F has been in existence since 1942; so therefore this experience has been during the period that Bulletin F was in existence.

Q. In other words, you don't know whether what you testified to has anything to do with Bulletin F specifically or not, do you?

A. I think it is consistent with Bulletin F because here they use the term "useful life" with the years as being three to five and an average of four.

Q. But in other words you were not testifying that every time you went in to see a Revenue Agent based on your experience they picked up Bulletin F and they interpreted it in a certain manner, are you?

A. It would be in a very small percentage of the cases in our discussion with Revenue Agents that they would ever refer to Bulletin F. We knew of Bulletin F, both ourselves and the agents.

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[fol. 40]

Redirect examination.

By Mr. Bernhard:

Q. Mr. Hoffman, you referred to a passage in Bulletin F that you read that mentioned useful life of automobiles by years as a guide?

A. Yes.

Q. What was that? What was the useful life set forth in Bulletin F as a guide to taxpayers?

Mr. De Santo: Your Honor, here it is and I am willing to put it in evidence.

The Court: I think you might as well. You both treated it as if it were in evidence.

Mr. Bernhard: I take it you agree Bulletin F sets up as a guide, three years and five years?

Mr. De Santo: I think Bulletin F speaks for itself.

The Court: It speaks for itself. Let us put it in evidence.

Mr. De Santo: We will introduce it as Government Exhibit 1 if there is no objection.

Mr. Bernhard: Is this the Bulletin F which was in effect during the years in question?

Mr. De Santo: I don't know the effective date of this.

Mr. Bernhard: That is the only question we have, your Honor. We want to have it in, but we would like to have the right Bulletin F.

Mr. De Santo: Have you got what you consider to be the right Bulletin F?

Mr. Bernhard: Your Honor, in order not to take time now could we check this later. Our only point is that this foreword may be added in this edition of Bulletin F.

The Court: Yes. Look it up during the recess.

Let the record show that there is an offer and a ruling that it is admissible.

[fol. 41]

By Mr. Bernhard:

Q. Mr. Hoffman, if a client of yours had a new asset purchased this year and it is improved on in subsequent years by the manufacturer would you advise that client to

write off the asset over a shorter period than the useful life adopted originally for the asset?

A. It would depend on the extent of the improvement, but normally improvements would not justify changing the useful life of the asset or the class of asset.

Q. And I suppose that the unpredictability of any such improvements or changes would have an effect also; isn't that right?

A. That is why obsolescence is normally ignored in computing useful life for depreciation purposes.

Mr. Bernhard: No further questions.

The Court: At this juncture may I ask counsel whether or not this stipulation might be put into the record? It should be.

Mr. Bernhard: Oh, yes, it should be.

The Court: We will mark it as part of the record stipulated by both parties.

GEORGE C. COURTOT, called as a witness on behalf of the plaintiff, having been duly sworn, testified as follows:

Direct examination.

By Mr. Bernhard:

Q. Will you state your full name, please?

A. George C. Courtot.

Q. Where do you live, Mr. Courtot?

A. I live in Florham Park, New Jersey, a suburb of Newark, New Jersey.

[fol. 42] Q. What is your business?

A. I am in the car and truck rental business.

Q. Located where?

A. At Newark, New Jersey.

Q. Are you in business for yourself?

A. Yes, I am.

Q. I take it you are a competitor of the plaintiff in this case?

A. Yes, I am.

Q. How long have you been engaged in that business for yourself?

A. For myself I have been in the business about a year and a half.

Q. What was your business prior to that?

A. I was in the car and truck rental business.

Q. For how long?

A. For a period of about 29 years.

Q. Were you connected with J. Frank Connor, Inc.?

A. Yes, I was.

Q. During what period?

A. I was connected with J. Frank Connor from 1935 to 1956, inclusive.

Q. In what capacity?

A. I was the secretary and general manager of the company.

Q. Your duties in that capacity were what?

A. I was in charge of all operations. I handled the purchasing and selling of cars and handled the hiring of personnel and supervision of maintenance and the administration.

Q. Would you give us a general description of the business of Connor, how it operated the leasing and renting of cars and trucks?

[fol. 43] A. Yes, we rented automobiles on a transit rental basis by the hour, day, or week to persons—that is, without drivers. We rented these vehicles without drivers to the general public and to industry.

Q. That is true of all vehicles, isn't it?

A. Yes.

Q. That you rented them without drivers?

A. Yes.

Q. That is the car rental and leasing business?

A. That is correct.

Q. You referred to rental and leasing. What do those terms mean in the trade?

A. The transit rental of a car would be the rental of a car for a short-term basis to a salesman or to an executive or an engineer having need of a car for a day or a week or possibly longer at a stipulated rate per mile and per hour or per day and per mile depending on the length of time he used the vehicle. In the case of leasing we leased automobiles for a period of a year or longer, a

specific car that would be placed in the hands of a person who would drive that car solely for his own use for a period of a year or longer on a monthly rate, straight monthly rate, quite possibly no charge for mileage.

Q. Now, your duties included purchasing cars from time to time?

A. Purchasing and selling automobiles.

Q. Your duties included the maintenance of those automobiles?

A. Yes, the supervision of the maintenance of the vehicles.

Q. What kind of a maintenance program did Connor have?

[fol. 44] A. We had a preventive maintenance program to keep the cars safely on the road and mechanically in good condition. At one thousand miles, for example, we would examine certain parts of the vehicle, steering, brakes, and so on. At two thousand or three thousand miles we would bring the vehicles in and give them another examination for other factors, safety factors, and so forth. At six thousand miles we would examine them again for another sort of mechanical inspection, and we kept that constantly in force throughout the entire life of the vehicle as long as we had it.

Q. And that was regularly maintained that way for all your cars?

A. Yes.

By the Court:

Q. That included, I suppose, a much more detailed examination than you have given? You would service the car just as any other owner would by greasing and oiling it and keeping the tires in good shape and that sort of thing?

A. Oh, yes, that came into the safety program, sir, the tires and brakes, and the cars were greased or lubricated regularly at the one thousand or fifteen hundred mile point. We kept records of each individual car when it would reach a certain mileage in our mileage book. We posted these records every day and still do. When it

reached a certain check point that car was written up immediately for whatever PM service it required at the time.

By Mr. Bernhard:

Q. From time to time you bought cars to be rented and leased as you described?

A. Yes, sir.

[fol. 45] Q. What governed your decision as to when to buy cars?

A. We were governed by the public demand for automobiles. If business warranted it we bought cars accordingly.

By the Court:

Q. What do you mean by public demand, please? Price?

A. No. The demand for our service.

Q. You mean the demands of your own business?

A. Yes.

By Mr. Bernhard:

Q. Any other factors involved in your making up your mind when to buy cars and when to sell cars?

A. Yes. As I say, the public demand, and then we would, of course, sell our cars when business would drop off or we would have a surplus of automobiles on hand, and if we were not operating our fleet at 75 or 80 per cent most of the time it was unprofitable and not economic.

By the Court:

Q. Did the state of the second-hand market have something to do with it?

A. No, it did not. It was strictly according to our business and what we could rent.

By Mr. Bernhard:

Q. I take it from what you say that sales and purchases did not necessarily accompany each other?

A. No, they did not.

Q. That sometimes you would drop off cars and reduce the number of cars you had?

A. Yes.

Q. Other times you might add to your fleet without selling any?

A. That is right.

[fol. 46] Q. Did what your competitors did have anything to do with your decision about purchases?

A. Yes, it has a great deal to do with it. Our competitors, as well as the public demand. If our competitors were leasing certain types of automobiles and that was the demand of the public, we would certainly have to coincide and keep up with the demand.

Q. Mechanical changes in cars?

A. And mechanical changes were very important, especially during the period where the automobile industry converted over to the automatic transmission. We found ourselves pretty much behind the thing, people coming in wanting to ride the car with the automatic transmission, and we just had to go out and buy them and put them in stock to satisfy our people.

Q. Did you also have the reverse experience in connection with the automatic transmission?

A. Yes, to some extent we did. A great many drivers who had been operating the conventional shift for years were reluctant to drive the automatic transmission. They were fearful that it would not take them up a hill, that it was not quite powerful enough, and so we had to keep both types of vehicles.

Q. In other words, with some customers they would demand a change and with other customers they would demand no change?

A. That is true.

Q. Did strikes or lockouts have any effect on your decision?

A. Yes, that had quite a bit. If you could not purchase automobiles due to a strike there would be a delay of months sometimes in moving out your equipment if it was excess equipment. You held on to your old equipment, and so forth, until you could expand with your new vehicles.

[fol. 47] Q. Did you have that experience?

A. Yes, we have had it. We have had an experience where the conveyors that carried vehicles from the factory would go on strike or production slow down because of a changeover, and so forth.

Q. Would whether we were at war or at peace have any effect on your decision?

A. It had a great deal to do with it. During the war years, of course, we were unable to purchase vehicles and we had to operate with what we had.

Q. Did general business conditions outside of your business have any effect?

A. Yes.

Q. Recession or prosperity?

A. Yes, it has an effect on our business. If there is a recession or a slowdown in production the engineer or salesman or executive is not getting around making calls, and they are reducing their forces, and that has a great deal to do with where our business comes from. In addition to a bit of pleasure riding and a vacation trip a great deal of it comes from the commercial person. A man in business will go out of town and in that town he will rent a car and make his calls and get on a train and go back to his office. We depend a great deal on that sort of trade.

Q. Do unexpected climatic conditions have an effect?

A. Yes, they would have an effect. We had one occasion, if I may mention it. We had a disaster in New England a few years ago where the telephone lines and so forth were pretty much in a bad mess, and we got called on by one of our fine accounts, the telephone company. They had to send hundreds of people up into the area to repair the lines, and the Red Cross came along and sent [fol. 48] representatives up there. That was a great demand on us for cars and they used these cars for a long period of time. It warranted our purchasing additional vehicles to supply our transit trade in the interim. For that reason we expanded our fleet.

Q. Business conditions changing immediately in your vicinity, would that have an effect on your business?

A. Yes, it would. A slowdown in our vicinity or something of that sort where we would not be renting, say, our

truckin' end of it, where we depend solely on the local people to rent our trucks, we would have a surplus of trucks on hand and we would have to dispose of them.

Q. When the airport opened up did that have an effect on your decision to purchase cars?

A. Yes. We opened up our airport in 1951. We never anticipated that it would do a great deal of business. However, it was a place of service for our people coming in on airplanes. In 1952 we had a bad experience in Newark. The airport was closed down after we had a few disasters there. Our business was closed out. We had no rentals at all. However, in 1954 the airport reopened and we were given a rather excellent location within the terminal and we started expanding from that point, and within a period of a year we increased sixty cars in our fleet—forty to sixty cars. I may be a little bit off. That is approximate.

Q. Is that a very unusual increase?

A. That was unusual. We never anticipated that volume of business from the airport. It was in an out-of-the-way place and in those days we didn't think too much of airport operations.

Q. Were any of these considerations that you have just described predictable?

[fol. 49] A. No, they were not.

Q. Mr. Courtot, the income tax returns filed by the corporation J. Frank Connor, Inc., did you sign those returns?

A. Yes, I did.

Q. Did they correctly show the dates of purchase and dates of sale of the automobiles used by Connor in the three years in question here and the amounts paid and the amounts received? All of the data are correct that you set forth in the income tax returns?

A. Yes, I examined those returns.

Q. Connor took a four-year life for its automobiles: is that right?

A. That is true.

Q. Are you familiar with the accepted practice in the rent-a-car business as to the number of months or years taken as to the useful life of automobiles?

A. Four years is the general practice.

The Court: That is, in this type of business? Was that your question?

Mr. Bernhard: Yes, in the rent-a-car field.

Q. Mr. Courtot, have you had any experience as a mechanic?

A. Yes, I have. In 1929 I started with the Hertz Drive-Ur-Self stations as a mechanic. I worked as a mechanic for two years under my father, who was the shop supervisor, and after that point I went into the office and became a desk man. I later became a station manager for the Hertz Drive-Ur-Self. At that point—that was just prior to going with Connor—I was in charge of the maintenance and handling of rentals of cars and trucks as a station manager.

[fol. 50] Q. In your own business right now, Mr. Courtot, what do you have to do with the mechanical side of the automobiles yourself?

A. Oh, I supervise the maintenance of the automobiles to this day. I make decisions on major repairs. My mechanic comes to me for final decisions where there are expenditures for replacement of a motor or relining of a brake, and so on and so forth.

Q. You make that decision on the basis of actual examination?

A. Yes, I examine them after he tears the motor down or after he pulls the brake shoe off, and so forth. I will examine it and make a recommendation as to whether he should go ahead with the sending out for the part.

Q. Mr. Courtot, as a practical matter is a car useful for rental purposes for longer than four years?

A. Yes. For rental purposes for longer than four years?

Q. Yes.

A. Yes.

Q. Under what circumstances?

A. Well, if we have to use these cars for a period of more than four years, which we have done in the past, during the war we ran them as long as six years—

Q. Were they economical?

A. (Continuing) However, we don't make a practice of it today. It is not economically feasible. It costs more

money to maintain your vehicle, even though you are up on your maintenance all the time, but after a two and a half or three year period it is starting to cost you money and it breaks down your profit. It is much better to sell them.

Q. When you say that you can use automobiles in the rental business for more than four years I am asking is it economically feasible to do that or wise to do that?

[fol. 51] A. No, it is not. It becomes costly.

Q. Can it be done profitably or does it mean a loss?

A. It would mean a loss to operate a car more than four years.

Q. When cars have been used for four years what do they bring in the market when they are sold for business purposes? Roughly in dollars what do they bring?

A. They probably bring around \$300 after four years.

The Court: You are talking about a special make of car or the light car, a small car?

Mr. Bernhard: No.

The Court: Are you talking about all cars?

The Witness: I would say generally in the medium car field, sir.

By Mr. Bernhard:

Q. That is after the use of four years?

A. After the use of four years it should bring at least \$250 to \$300.

Q. I suppose some cars bring substantially less than that?

A. Oh, yes.

Q. I am saying after four years?

A. Yes.

Q. When you were describing your maintenance program and examination of cars at the end of one thousand miles and what you did, two thousand miles and four thousand miles, and so on, am I right that you were referring to Connor?

A. Yes, I was.

Q. To what Connor did while you were there?

A. Yes, and what I am presently doing now.

Q. Also what you are presently doing now?

A. Yes.

[fol. 52] Q: But also what you did at Connor during the three years in question?

A. Yes.

Q. Ending March 31, 1954, 1955, and 1956?

A. Yes.

Mr. Bernhard: That is all.

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Redirect examination.

By Mr. Bernhard:

Q. Mr. Courtot, you were giving the practices of your competitors as one factor in connection with the sale of your cars for the purchase of new cars; is that right?

A. Yes.

Q. Were there other factors involved also?

A. In the sale and the purchase of cars?

Q. Yes.

A. Yes, as I said before, the change of mechanical conditions, customers' demand on the car and the type of vehicle.

Q. Would your business or the volume of your business have something to do with it?

A. The buying and the selling of cars?

Q. Yes.

A. Oh, yes.

Q. During this period the airport opened up; isn't that right?

A. Yes.

Q. Or at least the effects of the opening of the airport were felt during this period?

A. Yes, after 1952.

[fol. 53] Q. When the airport first opened up was there an immediate effect on your business or was it felt later?

A. No, there was no immediate effect. We were just delivering cars to the airport. We didn't have a set-up down there that was conducive to a full-fledged operation, but later on that was brought about.

Q. By later on you mean within the period 1954 to 1956?

A. Yes. As I mentioned before,—I think this is repeating myself—the airport in Newark, New Jersey was closed

down for 1952 and part of 1953 and it reopened again in February, 1953, and from that point on we started increasing our passenger car rental business.

Q. I suppose in 1953 you had not yet felt the full influence of the additional business?

A. No.

Q. During this period am I right that you were required to meet a bank loan?

A. Yes.

Q. Did that have any bearing on your operation?

A. Yes, I had to acquire moneys to pay off an obligation and finance notes, and I might say I had to pay the rent one time and I had to sell a car to do that.

Q. I take it again that these factors that you have now mentioned were not predictable by you in advance?

A. No, they were not.

Mr. Bernhard: That is all.

Mr. De Santo: Your Honor, we have found a Bulletin F.

Mr. Bernhard: Can we take a minute on this, your Honor?

The Court: Yes.

[fol. 54] Mr. Bernhard: Could we mark the one you offered and read from as Defendant's Exhibit 1A and the Bulletin F that actually applies to the years in question as Defendant's Exhibit 1B? They are both Bulletins F.

The Court: Can you agree on one which applies to the years in question by actual print? If you can't I will simply admit them. If you want to show that the difference is relevant, you may.

Mr. De Santo: Your Honor, let us offer them both so the record is complete.

The Court: All right.

(The Bulletins F were received in evidence and marked "Defendant's Exhibits Nos. 1A and 1B.")

GERALD J. PALMIERI, called as a witness on behalf of the plaintiff, having been duly sworn, testified as follows:

Direct examination.

By Mr. Bernhard:

Q. Your name, Mr. Palmieri?

A. Gerald J. Palmieri.

Q. Where do you live?

A. Maplewood, New Jersey, which is a suburb of Newark.

Q. What is your business or profession?

A. I am in the public accounting business. I am a C.P.A.

Q. Where do you practice as a C.P.A.?

A. My office is in Newark, New Jersey.

Q. Were you connected with J. Frank Connor, Inc.?

A. I have been connected with J. Frank Connor since 1935.

Q. From 1935 to what date?

[fol. 55] A. To 1956, approximately, June 1st.

Q. How long have you been a C.P.A., Mr. Palmieri?

A. Since 1950.

Q. What, if anything, did you have to do with the income tax returns that were filed by the corporation for the fiscal years ending March 31, 1954, 1955, and 1956?

A. I personally prepared the tax returns for the fiscal years.

Q. Were they true and correct as a reflection of the books and records of the company and the transactions of the company as far as you knew them?

A. Yes.

Q. I show you a document marked for identification Plaintiff's Exhibit 1 and ask you to examine that. That purports to be summary information disclosed by the income tax returns for the three years in question. Does it correctly show a summary of the information contained, as it purports to, of the depreciation claimed on automobiles and the method of computing the depreciation, and the same information for the trucks?

A. Yes. I have reviewed this schedule which was prepared from the tax returns prepared by me.

Q. And it is correct?

A. It is correct, sir, to the best of my knowledge.

Mr. Bernhard: We offer this, your Honor, as a summary of those returns.

Q. I show you a document that has been marked Plaintiff's Exhibit 2 for Identification. Will you examine that? That document purports to show the vehicles sold during the years set forth in the column under the heading "Year ended March 31st," and purports to show the cars sold in each of those fiscal years, the number sold and the [fol. 56] holding period in months, the average holding period, the longest holding period during each of those years and the shortest holding period during each of those years. Have you had an opportunity to check back and verify the correctness of that document?

A. Yes, I have. I reviewed this and checked it against the schedules as prepared on the tax returns for these fiscal years and I found them to be correct.

Q. They are correct?

A. Yes.

Mr. Bernhard: We offer Plaintiff's Exhibit 2, your Honor, in evidence.

The Court: Does the Government object to the offer of these exhibits?

Mr. De Santo: No, your Honor, we are going to let them go in.

The Court: There is an offer of both of those documents?

Mr. Bernhard: Yes, your Honor.

The Court: Let them both be admitted without objection.

(The summary of information contained on income tax returns with reference to depreciation and the summary showing vehicles sold during the years in question were received in evidence and marked "Plaintiff's Exhibits Nos. 1 and 2," respectively.)

By Mr. Bernhard:

Q. Mr. Palmieri, what experience, if any, did you have with the Treasury Department or the Internal Revenue Service in connection with Connor's depreciation rates or

the four-year life for the three years in question in this case?

A. We had an examination for the fiscal year ended March 31, 1955, at which time the tax return was reviewed. [fol. 57] Q. And what happened?

A. The return was accepted as filed with the exception of a minor adjustment in administrative expenses.

Q. Did that have anything to do at all with useful life or the depreciation rates?

A. It was reviewed generally, but nothing further was made of the issue.

The Court: That is not entirely responsive. I gather what the witness is saying is that there was a full review of the return at this period and that the Government took no exception to the practice of stating a certain useful life, and so on.

Mr. Bernhard: He said that there was an adjustment.

The Court: A minor adjustment which had nothing to do with this subject here. All right.

By Mr. Bernhard:

Q. Mr. Palmieri, as a C.P.A. do you have other clients who use automobiles in their business?

A. Yes, I do.

Q. What life do they take for their automobiles?

A. Average four years useful life for business purposes.

Mr. Bernhard: That is all.

WALTER JACOBS, called as a witness on behalf of the plaintiff, having been duly sworn, testified as follows:

Direct examination.

By Mr. Bernhard:

Q. Will you state your name?

A. Walter Jacobs.

Q. What is your business, Mr. Jacobs?

[fol. 58] A. I am president of The Hertz Corporation.

Q. How long have you been in that office?

A. In that particular office since 1954.

Q. Prior to that how long had you been in the rent-a-car business?

A. Forty years—no, thirty-six years prior to that.

Q. That is about forty years in all?

A. Forty years altogether.

Q. What are your duties as president of The Hertz Corporation?

A. Well, they are varied and manifold.

Q. Suppose we begin with the business of The Hertz Corporation. Give us a description of the business as it operates.

A. Well, the business of The Hertz Corporation is the renting and leasing of motor vehicles. We rent passenger cars on short-term daily and weekly bases, we rent passenger cars on a long-term basis; we rent trucks on a short-term basis and we rent trucks on a long-term lease basis. We have some ancillary activities like garage operations and gas station, but they are a very small part of our business.

Q. Over what area do you operate?

A. Throughout the world.

Q. What have been your connections with the rent-a-car business during this forty-year period, just briefly?

A. It is not very brief, forty years.

Q. Just in resume.

A. Well, I started the automobile rental business in Chicago in 1918 with twelve Ford cars and organized a company called Rent-A-Ford, Incorporated. Subsequently the business grew and we expanded to the use of other [fol. 59] automobiles and we changed the name to Rent-A-Car, Incorporated. Following that we liked the name "Yellow" because it was identified with a taxicab, so we adopted the name "Yellow Drive-It-Your-Self System". That was over the period of years from 1918 to 1923.

In 1923 I sold my business to John Hertz, who was then in the manufacturing as well as the cab business, and continued along in the business as vice-president.

This particular business formed the nucleus for the then expanded Hertz Drive-Your-Self Station, Inc.

In 1926 since the business became owned by Yellow Truck Manufacturing Company it was sold along with that

company to General Motors Corporation; and for the twenty-seven years intervening I actually became the operating head of all the Hertz operations, which were all the rent-a-car and truck operations, and in 1947 became president of some then six or seven Hertz Drive-Ur-Self companies.

In 1953 this business was sold to the Omnibus Corporation and I went along with the business; and in 1954 I became—when the Omnibus Corporation went out of the bus transportation business and into the automobile rental and truck rental business I became president of Omnibus Corporation.

That brings you right up to date.

Q. The Hertz Corporation operates a rent-a-car business itself and also through licensees?

A. We operate and own operations in some 170 cities and we franchise or there are independent businessmen engaged in the automobile rental business who operate under Hertz franchises and under the Hertz name in some additional 650 cities.

Q. In general what is the situation as to competition? [fol. 60] A. Well, competition seems to be growing along with the industry. There is quite a bit of competition. The last few years it has substantially increased and currently there is competition coming on the horizon. I think that is significant, but it is a good business.

Q. Would you say this is an industry which has grown rapidly or grown slowly? What has been its course in the last ten years?

A. Well, it has grown more rapidly in the past ten years than in the previous period. Its most rapid growth has been since World War II, and the idea of renting and leasing has come to be accepted by the public as a means of having an automobile at their disposal or a truck at their disposal without the need for ownership. It has become the more accepted way of life, and might even in some measure be referred to as a new way of life or a new concept of automobile ownership.

Q. In view of the newness of that business would you say that your business policies have had an opportunity to mature and solidify or are they still in flexible state? What is the situation about that in general?

A. I think it might better be stated that they are fluid of necessity, because when conditions change we are forced to change policies. That does not necessarily apply to all policies, but we must be flexible in some respects and we have had to make changes in very important policies over the years.

Q. What do you yourself have to do with buying cars and selling cars in the Hertz organization?

A. Actually the approval to purchase cars and the approval to sell cars is made by me and directions are given to staff assistants authorizing the purchase under certain terms and the sale under certain terms.

[fol. 61] Q. But the decision is made by you?

A. Originally. I do not physically sell all the cars or buy them.

Q. As far as the decision as to whether cars are to be bought or sold and when they are to be bought and when they are to be sold?

A. It is not always just that way, sir. Sometimes the decision is to make the effort to sell them and we do not succeed.

Q. From time to time as Hertz buys cars and sells cars what considerations govern your keeping them or selling them?

A. Well, I think there are a number of considerations, some over which we have no control. One most important one is the condition of the used car market at the time we plan to try to make replacements. If that is favorable we then can make replacements. If that is unfavorable we have to alter our thinking.

Other considerations are the economic conditions. If there is a recession, as there have been, we find that we have more cars than we need and we must sell them. If there are inflationary times or times of good business we find we need more cars.

Another factor is with new competition starting up they, of course, start out with new automobiles and there is the urge to try to match our competition, and therefore we sometimes are forced to make earlier replacements of our cars than we would like to make.

There are other factors such as wars. During the most recent war we could not obtain any new automobiles, and consequently we had to continue to operate our old ones. We would prefer not to do that for that long a period of time.

[fol. 62] Q. How long a period would you say that was?

A. I think we operated our fleet for some five or six years or maybe some as long as seven at that time. Of course, we came out into a very inflationary period and we were successful in selling our cars for very satisfactory sums. They were readily marketable.

Q. But during the period of the operation was that an economic operation?

A. We had great pain and suffering for the maintenance of those vehicles during that period and a great expense.

Q. Was that a situation which was forced on you?

A. Yes.

Q. Any other considerations which you can think of?

A. There is, of course, sometimes the factor of improvement such as the automatic transmission, power steering, power brakes, and those would encourage us to make replacement if it is economical to do so.

Q. Do strikes and lockouts have any effect on your decision?

A. It would have a very serious effect if it occurred at a time when we wanted to buy new cars and we could not get them because of the strikes or lockouts. They have occurred. There has been a General Motors strike of some duration some years ago. There could well be another one next year, I don't know, or this year.

Q. Did the advent of the small car have any effect on you?

A. It is something that is facing us. Should the small car be further developed and the lower-priced car become more in demand, we will have a very serious problem of trying to dispose of our presently high-cost cars without substantial loss in order to acquire and replace with smaller [fol. 63] cars and lower-cost cars. But if the public demands smaller cars we will have to get smaller cars, and naturally if we have to buy smaller cars, in order to provide

for funds for them we will have to sell some of our other cars.

Q. Is this also one of the factors involved in selling?

A. That is one. You can think of any number. Naturally, it is our desire and hope to make early replacement of vehicles, but that is not always possible.

Q. Are any of those considerations that you have named predictable?

A. I don't think they are predictable at all.

Q. Do you know now when you are going to sell the cars that you have on hand right now?

A. I can best illustrate that we don't know now and the reasons are very apparent. In the last quarter of last year we attempted to make a rather large-scale replacement of our fleet and placed orders for new vehicles in rather substantial number for the periods in October, November, December, January, and February. We have had the deliveries of the new cars and, naturally, have been forced to sell the old cars in order to provide some portion of the funds for the purchase of the new ones, and shortly after we started to get these deliveries for which we had already been committed the used car market literally fell out of bed, and we have sustained losses as against our book values on our fleet for the last quarter of last year and the first quarter of this year of something in the neighborhood of three-quarters of a million dollars. Now, I say that we did not forecast or foresee that and could not have unless we were crystal gazers.

Presently we don't know when our present fleet of 1957, 1958, and some 1956 cars—we don't know when we will be [fol. 64] able to sell them economically. We don't know when we will want to sell them economically. It could well be that this great competitive drive, which is one of the factors, might be relieved, because I am sure that the industry and competition may well be faced with the same problem we are.

By the Court:

Q. When you speak of your fleet and your operations you are only talking about the 170-odd cities in which Hertz

operates? You are not talking about your dealers or franchise-operated cities?

A. That is correct. We have nothing to do with their purchases.

Q. How many cars are there altogether?

A. In those 170 cities we have approximately 20,000 passenger cars and I think some 14,000 trucks.

By Mr. Bernhard:

Q. You say that the answers you have given apply to The Hertz Corporation?

A. That is correct.

Q. But from your experience in the business do they apply also to other rent-a-car operators?

Mr. De Santo: I object to that, your Honor, unless he knows.

The Witness: I do know.

Mr. De Santo: Does he know anything about Connor's operation?

By the Court:

Q. Do you?

A. Well, in a general way. Connor was a licensee of The Hertz System. I would not represent that I know the details of his tax report or anything of that nature, but I [fol. 65] do know that Connor was faced with the same economic factors as we were faced with in the periods under question.

By Mr. Bernhard:

Q. Are the factors that you have enumerated factors that loom large in the same problems and present the same problems for others in your industry as they present for you?

A. They always have. In fact, I attend industry meetings and talk with our competition, and they have had the same trials with disposition of old cars in the last four or five months that we have had.

Q. Is that true of your licensee as well as your competition?

A. Yes, sir.

Q. Mr. Jacobs, is there an accepted practice in the industry as to the number of months or years taken as the useful life of automobiles in that industry?

A. You are asking now about the industry generally, sir?

Q. Yes.

A. There are accepted practices. We have had—I have had occasion to have our treasurer on two previous periods send out questionnaires to our licensees to determine what basis they have used for depreciation, and some of them have used three years, three and a half years, and some five and five and a half years. But the high percentage of them, the majority of them by a large measure use a four-year life for the purpose of depreciation.

Q. Is that the useful life that The Hertz Corporation uses also?

A. Yes, sir.

Q. Is that four-year life taken only in cases where the rent-a-car operator keeps and uses the car for the full four- [fol. 66] year term, or is it also taken where the taxpayer keeps the car for less than that period?

A. It is taken irrespective of how long a period they retain the vehicle in their particular service. Actually, I have never known any other useful life for depreciation purposes in all the Hertz properties over the years that was not tantamount to a four-year life.

Q. What has been your experience with reference to the possibility as a practical matter of using an automobile for business purposes for a longer period than four years?

A. Well, as a practical matter it is our opinion that it is uneconomical to do so. We have on occasion done it, and we would have preferred not to.

Q. Mr. Jacobs, when cars which have been used for business purposes for four years are sold how much would they bring if purchased for business purposes?

A. Well, I have to go back a number of years to give you a full answer to that. Years ago we did operate vehicles for much longer periods than we do today before

we had this rising economy and favorable used car market, and in those years a four-year-old car generally sold in an as-is condition, which is the way we sell them, for anywhere from \$50 to \$200. If you want me to give you my estimate as to what a four-year-old car is selling for today on the used car lots, here again you have a car that has already been reconditioned, but I would say they may sell anywhere from \$100 to \$200 or maybe as high as \$300, but sometimes the reconditioning cost represents a good part of that. We do not attempt to revitalize, repaint, reupholster, or recondition our cars when we sell them. We sell them as-is.

Mr. Bernhard: That is all.

[fol. 67] Cross examination.

By Mr. De Santo:

Q. Mr. Jacobs, is it present policy of your organization to keep cars or automobiles longer than three years, sir?

A. Frankly, there is no such established policy. If you would ask me do we keep cars longer than three years presently or have we in the last five or six or seven years, the answer would be no, we do not.

Q. Are you familiar, sir, with the advertising of your organization?

A. Yes, sir.

Q. And certain things it emphasizes?

A. Yes, sir.

Q. Isn't there a certain emphasis placed on the Hertz advertising generally upon the newness and cleanness of the vehicle that you get when you rent a Hertz automobile?

A. There is, sir.

Q. That advertising factor is important in the business?

A. Most everybody in the industry advertises in that manner, so it must be important.

Q. So you would know, then, that this factor must be taken into consideration in the length of time you keep an automobile, wouldn't it?

A. It is a factor.

Q. It is certainly a factor you take into consideration?

A. But it is far from the sole factor. If we had to change our policy because of economic conditions that would be one factor we would disregard, and we may very well be headed for that kind of a period right now.

Q. You did after the war when it was necessary use cars in your business six or seven years, though, didn't you?

[fol. 68] A. During the war.

Q. And their physical life in the sense that they did not have to be junked had not expired, had it?

A. I would say that they were pretty much junk at this point, but they had a value.

Q. You were using them?

A. Yes, we had to use them. We had no others to use.

Q. So actually this four-year physical life does not exactly conform to the life you used or your own experience with a physical life of longer than that during the war years when it was necessary?

A. I don't think there is any relevancy between the periods that we used the vehicles and the useful life of the vehicles. They are two separate and distinct things.

Q. Let me ask you whether or not the physical life—you have already stated this really—whether the physical life is longer than four years, during the post-war period when you could not get new vehicles?

A. Well, I couldn't actually tell you how long the physical life of the vehicle is.

Q. Did you use them longer than four years?

A. I don't think anyone can tell you, because one vehicle may last fifteen years and one only three.

Q. Did you use them more than four years, sir?

A. We did on that occasion, yes.

Q. Did I understand you to say that certain losses were being suffered by Hertz?

A. Yes.

Q. In what year, sir?

A. In the latter part of 1957 and early part of this year, about a half million in the first quarter.

Q. Has that been true of prior years?

A. No.

[fol. 69] DONALD J. ERICKSON, called as a witness on behalf of the plaintiff, having been duly sworn, testified as follows:

Direct examination.

By Mr. Bernhard:

Q. Your full name, please, Mr. Erickson?

A. Donald J. Erickson.

Q. Where do you live?

A. I live at 137 Sheridan Road, Winnetka, Illinois.

Q. What is your business or profession?

A. I am a partner in the public accountant firm of Arthur Anderson & Company, a national firm of auditors and accountants.

Q. Are you yourself a certified public accountant?

A. I am a certified public accountant in the states of Illinois, Michigan, Indiana, Pennsylvania, and a number of other states.

Q. In what capacity are you associated with Arthur Anderson & Company?

A. My function is partner in charge of the office and to administer the affairs of that office, and in addition to that I am responsible for partnership supervision of our work in connection with a number of our clients. That means that I review and counsel with our staff in connection with certifying the financial statements for stockholders' purposes. I also review and supervise our work in connection with security registration before the SEC. I also have in the past and from time to time responsibility for special studies in the fields of depreciation rate making. I have testified in various states before commissions and courts in those states on matters with respect to rate making and with respect to depreciation in several of those jurisdictions.

[fol. 70] Q. What is the relationship between Arthur Anderson & Company and The Hertz Corporation?

A. Our firm is the auditor, the independent auditor for The Hertz Corporation.

Q. How long has that been true?

A. My recollection of that is it goes back to the period the company was known as The Hertz Corporation and back to the period of its predecessors, I would judge in the early forties or late thirties.

Q. Would you state your tax experience?

A. In connection with my responsibilities in connection with the clients' work that I supervise I also have supervisory responsibility with respect to the tax work that we do for those companies where we have that assignment. That means that I work with our people in their review and preparation of tax returns and in the review and preparation of tax claims where they are appropriate.

I also as partner in charge of our office counsel with all of our people as to tax problems that all the clients have that are more than the ordinary or out of the ordinary circumstances.

Q. Do you have anything to do with reviews or surveys in connection with taxes?

A. In connection with our work both in the field of taxes and in the field of audit examinations that we make from time to time we make special studies or reviews to determine general business practice to enable us to be better informed and to better counsel with our clients. We have done that in the field of depreciation and we have done that in the field of executive compensation and many other areas.

Q. Has your work included application of the provisions of Internal Revenue Codes with respect to the allowance of deductions for depreciation?

[fol. 71] A. Yes, it has.

Q. Are you authorized to represent taxpayers before the Treasury Department?

A. Yes, I am.

Q. And you have so represented them?

A. I have.

Q. Mr. Erickson, I want to give you a statement of hypothetical facts and at the end of that statement I will ask your opinion based on those facts.

Assume a taxpayer is in the car and truck renting and leasing business and acquires all of the vehicles which it uses in its business new. Its business consists of renting

cars and trucks without drivers to the public for short periods of time on an hourly, daily, or weekly basis, and to a much smaller extent leases some cars and trucks without drivers on a long-term basis for periods ranging from twelve to twenty-four months.

Assume that such rental cars are used either for pleasure or business and that the few leased vehicles are used solely for business.

Assume that all of the taxpayer's vehicles, including the vehicles leased on a long-term basis, receive under the direct supervision of the taxpayer regular preventive maintenance care.

Now, based on those facts and for the purposes of determining deduction for depreciation under Section 167 of the 1954 Internal Revenue Code, and particularly with reference to Sub-section C of that section where the term "useful life" is used, what is your opinion as to the useful life of such vehicles?

Mr. De Santo: Your Honor, I object. It is getting pretty close to the question before the Court.

[fol. 72] The Court: If it is based on his experience in the past I would overrule the objection. I don't think that the question calls for an actual interpretation of the words "useful life". It might indirectly, but I don't think it calls for the actual interpretation of the words "useful life" in the statute.

Your question is directed now, as I understand, to the experience in the past?

Mr. Bernhard: That is right.

The Court: As a C.P.A. having a general knowledge of this particular type of company?

Mr. Bernhard: And as a member of the firm of Arthur Anderson & Company, of which he is the Chicago managing partner, representing Hertz over a long period of years, with lengthy experience in this field.

The Court: I have permitted the certified public accountants to testify before very shortly that the useful life of the car was generally taken to be four years in the trade, and that the fact that they were not kept and owned by the original taxpayer made no difference, and really

this question is directed just about to that, except that it is more explicit inasmuch as it concerns the particular industry.

Mr. Bernhard: That is right.

Mr. De Santo: This question, of course, is different in this respect: He has specifically referred to useful life in 167 of the Code. He is not talking about experience under the 1939 Code at all. His question, as I understand, is with reference to the term "useful life" as used in 167 of the 1954 Code.

The Court: To that extent I would sustain your objection, because that is one of the answers which is called for in this case. I don't feel that this witness ought to [fol. 73] be allowed to testify what he thinks the term "useful life" means in the Code itself, because he would be coming to the conclusion that I must come to. I think based on his past experience with this particular line of industry, experience which he has had for years with the Hertz people, he can certainly say that up until this time his experience in this business would indicate that "useful life" means a certain thing but I would not want the question tied into the actual Code words of "useful life". Maybe I am being captious, I don't know, but I feel that the Government's objection is sound to that extent.

Mr. Bernhard: Your Honor, if the question were put exactly as it has been put so far as the recitation of the facts are concerned, because those facts just recited are, I think we all agree, the facts in this case as they have been developed from the witness stand, and if the question were put What would your advice be or your recommendation be to a client who was that taxpayer just described? I think perhaps it would not be subject to the objection.

Mr. De Santo: I don't think that corrects the objection at all, your Honor. His recommendation will be based on his opinion, certainly.

The Court: Why didn't you ask the question in this way and I certainly would permit it: In the past up to 1956 what has been your experience in claiming useful life on the set of facts which have just been given you in this hypothetical question? I think I would permit that without any doubt. The Government has taken a certain attitude

over the course of the years about this thing and you can certainly bring that out. I think it has some relevancy to this question I must determine. But you are asking the question I must determine. It is a conclusion of law on this and I want to keep away from that.

[fol. 74] Mr. Bernhard: Very well, your Honor. May I just press this one further point? The reason I asked if your Honor would permit asking what his recommendation would be is that it would then not be—

The Court: You are nearly right, based on his experience in the past. I think I will overrule the objection. If you want to re-frame the question you may. What would his advice be based on his experience in the past? I would permit the question to be answered, and I overrule the objection.

Mr. De Santo: Just for my own understanding, we are not mentioning 167 of the Code?

The Court: We are not mentioning the Code at all.

By Mr. Bernhard:

Q. Based on your experience in the past, Mr. Erickson, what would your advice be to a client who is the taxpayer just described?

A. Based on my experience my advice would be four years.

Q. Would your opinion as to the useful life of those vehicles be the same or different if it were shown that the taxpayer disposed of some or all of the vehicles before they were actually used by him in his business for four years or more?

A. My opinion would be the same, namely, four years.

Q. Would your opinion be the same or different if it were shown that annually there were changes in the style or design of the vehicles or that from time to time there were mechanical innovations such as power steering or automatic transmission, et cetera?

A. My opinion still would be the same or four years.

Q. You spoke earlier of having supervised the taking of surveys or reviews in connection with depreciation. Did that include depreciation on automobiles?

[fol. 75] A. Yes, sir. I have had made under my supervision an informal review of the practice of industry, not solely that of the rent-a-car business, but general businesses in many lines, and just as a rough example, we had accumulated companies whose gross sales were about five billion dollars, and in those cases the average life was four years and the preponderant use by these companies was four years.

Mr. Bernhard: That is all.

Cross examination.

By Mr. De Santo:

Q. Sir, if the Government had determined that you would take into consideration the innovations in the particular vehicles involved in determining the useful life would you still recommend to your client four years was the useful life?

A. My interpretation of "useful life" is the useful life for business purposes. My experience has been that companies using passenger vehicles are confronted with changes like that yearly, and my recommendation and my observation is that I would not change based on them.

Q. Even though the Government may have taken the position in a statute contrary to that?

A. I would say this: If we are looking for the useful life for business purposes, which is a product of experience, it seems to me the Government's position in the statute would not change what the useful life for business purposes is.

Q. In other words, Congress could not by statute change it?

Mr. Bernhard: I object, your Honor.

The Court: Supposing Congress put it down to one month? You would get to the question of confiscation. [fol. 76] There are so many angles. I am not certain your question isn't too general. The Congress has seen fit to say that you can't claim a certain kind of depreciation unless useful life is three years.

Mr. De Santo: That is right.

The Court: I don't see how this particular witness—he certainly can't go against that declaration, and if useful life is less than three years that is the end of it.

Mr. De Santo: Well, my question was if Congress had provided that physical innovations were to be taken into consideration in determining the useful life, whether his recommendation would still be the same.

The Witness: Is that a question?

Mr. De Santo: Yes.

The Court: I will allow it to be answered. I think it might be objectionable, I don't know.

Mr. Bernhard: Your Honor, I do object to it.

The Court: State your grounds.

Mr. Bernhard: If the Court please, there is a tremendous difference from the plaintiff's point of view certainly between a change in the law made by Congress and a regulation issued by the Treasury Department.

The Court: Oh, I would agree and I think counsel for the Government would have to agree within a certain area there is a substantial difference.

Mr. De Santo: Your Honor, perhaps I am wrong, but let me just state our position here. We permitted the witness to answer these questions, and implicit in his answers is an assumption as to what the law provided prior to the 1954 Code.

The Court: That is true, because it was based on his experience, I suppose, for twenty years or more. This witness can say that he has advised clients in this particular kind of industry and he has advised them successfully because the Government has never taken a position [fol. 77] contrary to that, and I think that is relevant in this case. I suppose it is also relevant that the implication that this particular client does not always keep cars for as much as three years is there. So I think that is admissible. Let us go back to the question that was asked.

(The following was read by the Reporter:)

"Well, my question was if Congress had provided that physical innovations were to be taken into consideration in determining the useful life, whether his recommendation would still be the same."

The Court: I think that gets to be argumentative in a situation that is not before us. I sustain the objection to that because Congress did not do such a thing.

Mr. De Santo: Very well, your Honor.

By Mr. De Santo:

Q. Now, this physical life that you are mentioning, the four-year physical life, is that an average physical life?

A. That would be the life from my experience that the preponderant number of companies use and would also be the average.

Q. It would be the average? In other words, it could be less and it could be more? The figure four is an average, but most of the companies use four years? Or do they use it because it is an average or do they use it because the physical life expires in four years?

A. That is the experience these companies have had with passenger vehicles used for business purposes.

Q. By "physical life" do you mean do they wear out in four years?

Mr. Bernhard: May I just interrupt, your Honor? We have now begun to use interchangeably "physical life" and "useful life." I think counsel is really cross-examining on what the witness has said about useful life, but he is calling it "physical life." If we understand each other I am satisfied.

[fol. 78] The Court: Presumably this witness is prepared to take care of himself on that, and I am sure he sees the difference in the question, and I would let him answer the question.

(The last question was read by the Reporter as follows:)

"Question: By 'physical life' do you mean do they wear out in four years?"

A. Well, let me make the same observation which I was about to, that I have not used the term "physical life." I prefer the term "useful life for business purposes." So far as the useful life for business purposes is concerned, that is exhausted at the end of four years.

By Mr. De Santo:

Q. In all cases?

A. I would say that is the general experience. There may be exceptions, but that is my general experience.

Q. There can be exceptions?

A. I don't know of any specifically.

Q. Can you tell me just roughly what you as an accountant or partner in Arthur Anderson would determine this life on? Is this an arbitrary four-year figure you just pick up just like that?

A. No, sir, it is the result of my experience in public accounting for some twenty-two years, working on a daily and rather close basis with clients in many different fields, and that is the result of my experience in working in all of these different areas and auditing tax systems, and that is my judgment and my experience in arriving at that conclusion.

Q. It is an average made up of all your experience?

A. It is also the specific use by the preponderant number of companies.

Q. When you are required to make an estimate of the physical life of a particular asset do you make any attempt [fol. 79] to determine how that asset is used in the particular business?

A. Let me say that I do not quite know what you mean when you say I make the estimate of physical life. I was observing what my experience has been as to the practices of industry and clients. I don't know of any occasion where I make the estimates. We recommend to people based on our experience.

Q. That is what I am trying to drive at. Certainly your experience depended upon some kind of investigation, didn't it?

A. Yes, sir.

Q. When you are faced with this problem and a new asset is purchased and you must determine what its useful life is, do you just go to a bulletin and take out a figure?

A. I may again, sir, state that there are many factors to be taken into account in setting the life of a new asset, as you phrase it, including the views of engineers, manage-

ment, and accountants, and I would go to the management and to the engineers and to the others and get their views.

Q. Based upon what they tell you that useful life can vary, can't it?

A. Not based on the experience. If the question is phrased to me as to what has been the experience, what in my opinion is the general experience of these companies, I don't believe that varies.

Q. You do determine the useful life upon what they tell you? You don't go to a book and take an average useful life? You admitted that.

A. No, I don't do it that way. Our advice is based on our experience in dealing with the experience of companies generally.

Q. Does the nature of the business have anything to do with it?

[fol. 80] A. The nature of all of the businesses is involved.

Q. It is important?

A. The nature of all the businesses.

The Court: Let us not talk at cross purposes. You are talking about the car rental business, are you not?

Mr. De Santo: Right.

The Court: I don't want the witness to be misled into all types of businesses. We are just talking about this type of business.

Mr. De Santo: All right, your Honor.

By Mr. De Santo:

Q. Did I understand your answer to be that the particular nature of the business would be a factor to be considered, whether it was car rental or some other business?

A. As to passenger cars, if that is what we are speaking of here, the nature of all of the users of passenger cars for business purposes is what we would take into consideration.

Q. In other words, a taxicab company would be treated the same way as an organization that had a company car just for their officials to drive their officials back and forth to town? They both would have a four-year physical life?

A. I would say they would be using cars for business

purposes. Whether they would have four years or not would depend on the physical facts of that particular car. If it was consumed it would take the life of consumption.

By the Court:

Q. Probably a taxicab company is not a very good example?

A. No, sir.

Q. The wear and tear in that particular line of business is probably a little more severe than any other, or am I wrong?

[fol. 81] A. You are very right.

Q. But I don't think you two are apart at all. The taxicab is the extreme on one side and there may be a business such as the Du Pont organization which has many cars and which its employees drive, and they are highly maintained, and that might be the best example on the other end of the pendulum, and all you are saying is four years is the average in all types of business cars?

A. Exactly.

By Mr. De Santo:

Q. If it is the average you must certainly as far as the automobile is concerned determine what use the automobile is going to be put to by the particular company before you can come to a snap conclusion. You just don't take four years?

A. I was speaking of my experience. I took what my experience happened to be.

Q. Let me ask you again if in your experience you have not had occasion to apply a four-year useful life under your impression of that term to automobiles that were not retained by the taxpayer for four full years?

A. Yes.

Q. You have?

A. Yes.

Q. When in a particular business you are faced with that prospect you don't make any attempt to trace that vehicle into the hands of the purchaser to determine what the service life of it is, do you?

A. I don't quite see where we function in tracing it to the particular purchaser. Could you clarify your question?

Q. I mean if you had that kind of experience in applying it, you have never bothered, I take it, or never actually in determining your four-year physical life with regard to [fol. 82] the particular business, traced it into the hands of any purchaser to determine what its actual physical life was, have you?

A. I don't recall any experience of tracing cars such as you describe.

Q. In your experience, sir, what is obsolescence?

A. Are you asking me for a definition of "obsolescence"?

Q. I am asking you what you have regarded it to be in advising your taxpayers over a period of years?

A. "Obsolescence" is a function of depreciation. It is one of the causes leading to the eventual retirement of a fixed asset.

Q. If this factor were present in any particular case at the time the asset is purchased, if you knew that it would have a usefulness shorter than its physical life, would you take it into account in determining the depreciation rates of the taxpayer?

Mr. Bernhard: I object to that, your Honor, because it is not based on anything in this case. This is an "if" question based on no evidence in this case.

The Court: State your reason why you think the question is relevant, Mr. De Santo.

Mr. De Santo: Your Honor, everybody that the plaintiff has offered has testified that one factor to be considered competitively and otherwise is the fact that an automobile owned by Connor sometimes became unuseful because of new developments such as power steering, which was an example given by plaintiff's witness.

The Court: We can't try this lawsuit based upon the life of one car. It is based on the grand average of experience, and I think this witness or any other witness would admit that one particular car might live four years and another only two or three months. The first one might

[fol. 83] be in excellent condition and never have been in an accident, and just by sheer accident might have been driven carefully. The other one might have been banged up right away and had hard usage, and so forth.

Mr. De Santo: May I change the question?

The Court: Yes.

By Mr. De Santo:

Q. In your experience with the Hertz system as one of your clients—you have done a lot of audits for the car rental business also—has the factor of obsolescence been considered by you?

A. As I testified, obsolescence is a factor of depreciation, and the factor of obsolescence in connection with the useful life of passenger cars for business purposes plus all the other factors of depreciation in my experience and my consideration lead to a conclusion of a useful life of four years for business purposes.

Q. If you had a taxpayer who has from his own experience consistently shown that they held the vehicles they used an average time of less than four years or even less than three years, and this experience was true over a period of nine or ten years, would you take that factor into consideration?

A. I again would go to the useful life of that asset for business purposes. I would not limit my conclusion to the experience of one taxpayer.

Q. Would you not consider it?

A. I would give it some consideration, but I would give more consideration—in fact, the heavy emphasis is as to the general experience of the use of that asset for business purposes.

Q. Since you have this one concept of a business life of four years and an actual experience in front of you of a taxpayer getting rid of his automobiles in less than four years consistently, what do you attribute this difference in times to?

[fol. 84] Mr. Bernhard: I object only to the term "consistently." In this case the figures—I did not object when counsel said nine or ten years, which is a considerable ex-

pansion of what is shown here, and in some of those years what counsel is basing his question on did not appear, and the cars were held for longer, but I think I must object to this question.

The Court: I overrule it, I think in the interest of time, and the fact that there is no jury. I don't think any real prejudice will result.

(The last question was read by the Reporter as follows:)

"Question: Since you have this one concept of a business life of four years and an actual experience in front of you of a taxpayer getting rid of his automobiles in less than four years consistently, what do you attribute this difference in times to?"

By Mr. De Santo:

Q. This actual difference in the length of time held and the length of time that you consider the physical life of the asset?

A. Again I go back to the actual experience I considered, which is the experience that business have with that asset, businesses which use it for business purposes, and I would say that establishes what the business useful life is.

Q. You ignore completely the fact that the taxpayer does not get that use out of it?

A. No, I do not. I am taking the experience of all users of passenger automobiles.

By the Court:

Q. Wouldn't it be possible, Mr. Erickson, that Hertz might find that any car over six months would not be advisable to be retained because of public demand for new [fol. 85] cars; still the useful life of that vehicle might still be four years?

A. Very definitely.

Q. So the experience of the business as to how long it wants to keep a car does not necessarily dictate what the useful life of that particular car is?

A. That is exactly right, sir.

Q. It may be a factor, but not an important one?

A. You take into account the experience of all users of passenger cars for business purposes.

The Court: Go ahead.

By Mr. De Santo:

Q. I still don't have an answer to what you attribute that difference to.

A. The point we are looking for is What is the useful life for business purposes of that asset? and the experience of the users is four years. The extent to which the individual taxpayers may vary from that is for various policy reasons which I am not equipped to answer. That is a management decision and not one that I can answer under those circumstances.

Mr. De Santo: Very well.

[fol. 86]

IN THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,799

THE HERTZ CORPORATION, a corporation (SUCCESSOR BY
MERGER TO J. FRANK CONNOR, INC., a corporation), Appellee;

v.

UNITED STATES OF AMERICA, Appellant.

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT
COURT FOR THE DISTRICT OF DELAWARE

Appellant's Appendix—Filed February 12, 1959

Charles K. Rice, Assistant Attorney General, Lee
A. Jackson, I. Henry Kutz, Myron C. Baum, At-
torneys, Department of Justice, Washington 25,
D.C.

Leonard G. Hagner, United States Attorney.

[File endorsement omitted]

[fol. 89]

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[fol. 90]

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

Civil Action No. 1921

THE HEBTZ CORPORATION, a corporation (SUCCESSOR BY
MERGER TO FRANK CONNOR, INC.),

v.

UNITED STATES OF AMERICA.

DOCKET ENTRIES

1. Sept. 4, 1957—Complaint; summons issued (Exit papers to Marshal).
2. Sept. 12, 1957—Marshal returns on summons marked served 9/5/57.
3. Nov. 4, 1957—Answer.
- PT. Apr. 10, 1958—Pre-trial conference, Layton, J.
4. Apr. 15, 1958—Transcript of pre-trial conference.
5. Apr. 16, 1958—Pre-trial brief for defendant.
6. Apr. 16, 1958—Stipulation of Facts.
- T. Apr. 16, 1958—Trial to the Court, Layton, J.
- H. Apr. 17, 1958—Oral argument after trial.
7. Apr. 23, 1958—Transcript of trial and oral argument after trial.
8. Apr. 23, 1958—Reporter's shorthand notes of trial and oral argument after trial.
9. May 1, 1958—Proposed findings of fact and conclusions of law submitted by plaintiff.

[fol. 91]

10. May 1, 1958—Brief for plaintiff.
11. May 13, 1958—Stenotype notes of pre-trial.
12. May 22, 1958—Brief of defendant U.S.A.
13. May 22, 1958—Proposed findings and conclusions of deft. U.S.A.
14. June 5, 1958—Reply brief for pltf.
15. July 17, 1958—Opinion, Layton, J. (formal order to be presented by counsel)
Notice to counsel²
16. Oct. 14, 1958—Judgment, Layton, J., in favor of pltf. and against deft. for principal amount of \$100.15 for fiscal year ended 3/31/54; \$4,044.54 for fiscal year ended 3/31/55; and \$10,222.63 for fiscal year ended 3/31/56, all with interest at 6%; and judgment is accordingly entered for total sum of \$14,367.32 with interest and costs. (Notice to counsel)
17. Nov. 19, 1958—Notice of Appeal by deft. U.S.A. (Notice to 3rd. CCA and counsel)
18. Dec. 8, 1958—Motion of deft. to withdraw exhibits and order, Layton, J. granting motion (Exit exhibits to L. G. Hagner, Esq.)

IN UNITED STATES DISTRICT COURT

EXHIBIT C TO COMPLAINT

FORM 605 MAR. 23, 1960		U. S. TREASURY DEPARTMENT - INTERNAL REVENUE SERVICE CLAIM TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID		District Director's Stamp (Date received)
The District Director will indicate in the check below the kind of claim filed, and fill in, where required:				
<input type="checkbox"/> Refund of Taxes Illegally, Unlawfully, or Excessively Collected; <input checked="" type="checkbox"/> Refund of Amount Paid for Stamps Overpaid, or Used in Error or Excess; <input type="checkbox"/> Abatement of Tax Assessed (not applicable to estate, gift, or income taxes)				
PLEASE TYPE OR PRINT PLAINLY				
Name of taxpayer or purchaser of stamps A. FINE, JR., JR.				
Number and address City, town, postal zone, State 28 Pine Street South, N. J.				
1. Current in which return (if any) was filed 1954				
2. Name and address shown on return, if different from above				
3. Period - If tax reported on annual basis, prepare separate form for each taxable year From April 1, 1954 To March 31, 1954 Kind of tax Income tax				
4. Amount of government \$10,000.00				
5. Dates of payment June 15, 1954; Sept. 9, 1954; Dec. 2, 1954; and Mar. 4, 1955				
6. (For stamps paid purchased from the Government) Not applicable				
7. Amount to be refunded \$10,000.00 Amount to be shown (not applicable to income, gift, or estate taxes) Not applicable				
8. The taxpayer believes that this claim should be allowed for the following reasons:				

(The taxpayer's statement attached
 hereto and made a part hereof.)

Use reverse if space is not sufficient.

I declare under the penalties of perjury that this claim (including any accompanying affidavits and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed

A. FINE, JR., JR.

Date **September 20, 1955**

/s/ ROBERT A. PETRE

INSTRUCTIONS

1. The claim must set forth in detail each ground upon which it is made and furnish evidence to support the Commissioner of the exact dollar amount.
2. If a claim covering two years was filed for the year for which the claim is made, then furnish and write over each year claim even though only one had been made.
3. Whenever it is necessary to have the claim examined by an agent or collector of the taxpayer, an authenticated copy of the document supporting the claim must be sent to the agent or collector to have the claim examined.
4. If a return is filed by an individual and a refund claim is claimed thereon by a legal representative of the decedent, surviving spouse of the decedent, or other person entitled to a refund of the tax.

or other similar evidence must be attached to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter claims to be filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary must accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still alive.

5. Where the taxpayer is a corporation, the claim will be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.

[fol. 92]

IN UNITED STATES DISTRICT COURT

EXHIBIT C TO COMPLAINT

[fol. 93]

J. FRANK CONNOR, INC.,
c/o THE HERTZ CORPORATION,
218 South Wabash Avenue,
Chicago 4, Illinois.

A STATEMENT ATTACHED TO AND MADE PART OF CLAIM FOR
REFUND OF INCOME TAX FOR FISCAL YEAR ENDED MARCH
31, 1954

[COPY]

Pursuant to Revenue Ruling 54-17, 1954-1 CB160, this claim for refund as filed by The Hertz Corporation, a Delaware corporation, in the name of and on behalf of J. Frank Connor, Inc., a New Jersey corporation, said J. Frank Connor, Inc., having been merged, by statutory merger under the Delaware General Corporation Law and Title 14 of the Revised Statutes of New Jersey, into said The Hertz Corporation on July 5, 1956. In accordance with Revenue Ruling 54-17, there are attached hereto: (a) a copy of the Certificate of Ownership merging J. Frank Connor, Inc., into The Hertz Corporation, duly certified by the Secretary of State of the State of Delaware, and (b) a copy of the Agreement of Merger between The Hertz Corporation and J. Frank Connor, Inc., duly certified by the Secretary of State of the State of New Jersey.


On or about June 10, 1954, J. Frank Connor, Inc., filed its U.S. Corporation Income Tax Return for its fiscal year ended March 31, 1954. On that return, the Taxpayer claimed \$180.92 as a depreciation deduction with respect to new automobiles acquired by the Taxpayer after December 31, 1953, the original use of which automobiles commenced with the Taxpayer and commenced after such date. Said depreciation deduction for automobiles was computed on the [fol. 94] basis of a four (4) year life, using rates of thirty per cent (30%) for each of the first two years and twenty per cent (20%) for each of the last two years. In addition, the Taxpayer on that return claimed \$71.37 as a depreciation deduction with respect to new trucks acquired by the Taxpayer after December 31, 1953, the original use of which trucks commenced with the Taxpayer and commenced after such date. Said depreciation deduction for trucks was computed on a straight line basis using useful lives as follows:

vans and heavy-duty trucks—five (5) years; other trucks—four (4) years; however, trucks acquired after December 31, 1953, but prior to April 1, 1954, were depreciated at the rate of three cents (\$0.03) per mile.

This claim for refund is filed for the purpose of changing the Taxpayer's election to compute depreciation on said automobiles and trucks for its fiscal year ended March 31, 1954, from the above-mentioned methods to an election to compute depreciation on said automobiles and trucks for its fiscal year ended March 31, 1954, on the declining balance method, using a rate of two hundred per cent (200%) of the straight line rate, as permitted under Section 167 of the 1954 Internal Revenue Code. Accordingly, the Taxpayer hereby makes such change of election, pursuant to Regulation 1-167(c)-1(e) of the Income Tax Regulations under the 1954 Internal Revenue Code, and hereby makes claim for refund of income tax paid for its fiscal year ended March 31, 1954, in the amount of \$100.15 (together with applicable interest thereon), which amount the Taxpayer has computed as follows:

80

[fol. 95]

(See Opposite) 

	Automobiles	Trucks	Total
Depreciation claimed per return on new automobiles and trucks acquired by taxpayer after December 31, 1953, original use of which commenced with taxpayer after such date.....	\$180.92	\$71.37	\$252.29
Depreciation on said items using declining balance method at 200% of straight line rate.....	302.14	142.74	444.88
Additional depreciation allowable.....	121.22	71.37	192.59
Less increase in capital gains attributable to use of declining balance method at 200% of straight line rate.....	0	0	0
Reduction of taxable income.....	121.22	71.37	192.59


Tax reduction at applicable rates:

For additional depreciation allowable..... \$100.15

Less increase in capital gain tax..... 0

Net tax reduction..... 100.15

EXHIBIT D TO COMPLAINT

(See Opposite) 

IN UNITED STATES DISTRICT COURT

EXHIBIT D TO COMPLAINT

U. S. TREASURY DEPARTMENT - INTERNAL REVENUE SERVICE		Return Made's Stamp (Date received)	
Form 967 REV. 1-20-1935		CLAIM	
TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID			
The District Director will refund to the claimant the amount of claim filed, and 5% in, where required			
<input type="checkbox"/> Refund of Taxes Illegally, Excessively, or Excessively Collected. <input type="checkbox"/> Refund of Amount Paid for Stamps Unused, or Used in Error or Excess. <input type="checkbox"/> Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).			
PLEASE TYPE OR PRINT PLAINLY			
Name of taxpayer or purchaser of claim: W. J. B. Corporation, 222 South Street, Chicago, Ill.			
1. District in which return (if any) was filed South, S. J.		2. Name and address of return, if different from above W. J. B. Corporation Report 2, S. J.	
3. Period - 1934-35 returned on annual basis 1934-35 per each year		4. Kind of Income tax	
5. Amount of 1934-35 return: 1934-35 1935-36 1936-37 1937-38 1938-39 1939-40 1940-41 1941-42 1942-43 1943-44 1944-45 1945-46 1946-47 1947-48 1948-49 1949-50 1950-51 1951-52 1952-53 1953-54 1954-55 1955-56 1956-57 1957-58 1958-59 1959-60 1960-61 1961-62 1962-63 1963-64 1964-65 1965-66 1966-67 1967-68 1968-69 1969-70 1970-71 1971-72 1972-73 1973-74 1974-75 1975-76 1976-77 1977-78 1978-79 1979-80 1980-81 1981-82 1982-83 1983-84 1984-85 1985-86 1986-87 1987-88 1988-89 1989-90 1990-91 1991-92 1992-93 1993-94 1994-95 1995-96 1996-97 1997-98 1998-99 1999-00 2000-01 2001-02 2002-03 2003-04 2004-05 2005-06 2006-07 2007-08 2008-09 2009-10 2010-11 2011-12 2012-13 2013-14 2014-15 2015-16 2016-17 2017-18 2018-19 2019-20 2020-21 2021-22 2022-23 2023-24 2024-25 2025-26 2026-27 2027-28 2028-29 2029-30 2030-31 2031-32 2032-33 2033-34 2034-35 2035-36 2036-37 2037-38 2038-39 2039-40 2040-41 2041-42 2042-43 2043-44 2044-45 2045-46 2046-47 2047-48 2048-49 2049-50 2050-51 2051-52 2052-53 2053-54 2054-55 2055-56 2056-57 2057-58 2058-59 2059-60 2060-61 2061-62 2062-63 2063-64 2064-65 2065-66 2066-67 2067-68 2068-69 2069-70 2070-71 2071-72 2072-73 2073-74 2074-75 2075-76 2076-77 2077-78 2078-79 2079-80 2080-81 2081-82 2082-83 2083-84 2084-85 2085-86 2086-87 2087-88 2088-89 2089-90 2090-91 2091-92 2092-93 2093-94 2094-95 2095-96 2096-97 2097-98 2098-99 2099-00 2100-01 2101-02 2102-03 2103-04 2104-05 2105-06 2106-07 2107-08 2108-09 2109-10 2110-11 2111-12 2112-13 2113-14 2114-15 2115-16 2116-17 2117-18 2118-19 2119-20 2120-21 2121-22 2122-23 2123-24 2124-25 2125-26 2126-27 2127-28 2128-29 2129-30 2130-31 2131-32 2132-33 2133-34 2134-35 2135-36 2136-37 2137-38 2138-39 2139-40 2140-41 2141-42 2142-43 2143-44 2144-45 2145-46 2146-47 2147-48 2148-49 2149-50 2150-51 2151-52 2152-53 2153-54 2154-55 2155-56 2156-57 2157-58 2158-59 2159-60 2160-61 2161-62 2162-63 2163-64 2164-65 2165-66 2166-67 2167-68 2168-69 2169-70 2170-71 2171-72 2172-73 2173-74 2174-75 2175-76 2176-77 2177-78 2178-79 2179-80 2180-81 2181-82 2182-83 2183-84 2184-85 2185-86 2186-87 2187-88 2188-89 2189-90 2190-91 2191-92 2192-93 2193-94 2194-95 2195-96 2196-97 2197-98 2198-99 2199-00 2200-01 2201-02 2202-03 2203-04 2204-05 2205-06 2206-07 2207-08 2208-09 2209-10 2210-11 2211-12 2212-13 2213-14 2214-15 2215-16 2216-17 2217-18 2218-19 2219-20 2220-21 2221-22 2222-23 2223-24 2224-25 2225-26 2226-27 2227-28 2228-29 2229-30 2230-31 2231-32 2232-33 2233-34 2234-35 2235-36 2236-37 2237-38 2238-39 2239-40 2240-41 2241-42 2242-43 2243-44 2244-45 2245-46 2246-47 2247-48 2248-49 2249-50 2250-51 2251-52 2252-53 2253-54 2254-55 2255-56 2256-57 2257-58 2258-59 2259-60 2260-61 2261-62 2262-63 2263-64 2264-65 2265-66 2266-67 2267-68 2268-69 2269-70 2270-71 2271-72 2272-73 2273-74 2274-75 2275-76 2276-77 2277-78 2278-79 2279-80 2280-81 2281-82 2282-83 2283-84 2284-85 2285-86 2286-87 2287-88 2288-89 2289-90 2290-91 2291-92 2292-93 2293-94 2294-95 2295-96 2296-97 2297-98 2298-99 2299-00 2300-01 2301-02 2302-03 2303-04 2304-05 2305-06 2306-07 2307-08 2308-09 2309-10 2310-11 2311-12 2312-13 2313-14 2314-15 2315-16 2316-17 2317-18 2318-19 2319-20 2320-21 2321-22 2322-23 2323-24 2324-25 2325-26 2326-27 2327-28 2328-29 2329-30 2330-31 2331-32 2332-33 2333-34 2334-35 2335-36 2336-37 2337-38 2338-39 2339-40 2340-41 2341-42 2342-43 2343-44 2344-45 2345-46 2346-47 2347-48 2348-49 2349-50 2350-51 2351-52 2352-53 2353-54 2354-55 2355-56 2356-57 2357-58 2358-59 2359-60 2360-61 2361-62 2362-63 2363-64 2364-65 2365-66 2366-67 2367-68 2368-69 2369-70 2370-71 2371-72 2372-73 2373-74 2374-75 2375-76 2376-77 2377-78 2378-79 2379-80 2380-81 2381-82 2382-83 2383-84 2384-85 2385-86 2386-87 2387-88 2388-89 2389-90 2390-91 2391-92 2392-93 2393-94 2394-95 2395-96 2396-97 2397-98 2398-99 2399-00 2400-01 2401-02 2402-03 2403-04 2404-05 2405-06 2406-07 2407-08 2408-09 2409-10 2410-11 2411-12 2412-13 2413-14 2414-15 2415-16 2416-17 2417-18 2418-19 2419-20 2420-21 2421-22 2422-23 2423-24 2424-25 2425-26 2426-27 2427-28 2428-29 2429-30 2430-31 2431-32 2432-33 2433-34 2434-35 2435-36 2436-37 2437-38 2438-39 2439-40 2440-41 2441-42 2442-43 2443-44 2444-45 2445-46 2446-47 2447-48 2448-49 2449-50 2450-51 2451-52 2452-53 2453-54 2454-55 2455-56 2456-57 2457-58 2458-59 2459-60 2460-61 2461-62 2462-63 2463-64 2464-65 2465-66 2466-67 2467-68 2468-69 2469-70 2470-71 2471-72 2472-73 2473-74 2474-75 2475-76 2476-77 2477-78 2478-79 2479-80 2480-81 2481-82 2482-83 2483-84 2484-85 2485-86 2486-87 2487-88 2488-89 2489-90 2490-91 2491-92 2492-93 2493-94 2494-95 2495-96 2496-97 2497-98 2498-99 2499-00 2500-01 2501-02 2502-03 2503-04 2504-05 2505-06 2506-07 2507-08 2508-09 2509-10 2510-11 2511-12 2512-13 2513-14 2514-15 2515-16 2516-17 2517-18 2518-19 2519-20 2520-21 2521-22 2522-23 2523-24 2524-25 2525-26 2526-27 2527-28 2528-29 2529-30 2530-31 2531-32 2532-33 2533-34 2534-35 2535-36 2536-37 2537-38 2538-39 2539-40 2540-41 2541-42 2542-43 2543-44 2544-45 2545-46 2546-47 2547-48 2548-49 2549-50 2550-51 2551-52 2552-53 2553-54 2554-55 2555-56 2556-57 2557-58 2558-59 2559-60 2560-61 2561-62 2562-63 2563-64 2564-65 2565-66 2566-67 2567-68 2568-69 2569-70 2570-71 2571-72 2572-73 2573-74 2574-75 2575-76 2576-77 2577-78 2578-79 2579-80 2580-81 2581-82 2582-83 2583-84 2584-85 2585-86 2586-87 2587-88 2588-89 2589-90 2590-91 2591-92 2592-93 2593-94 2594-95 2595-96 2596-97 2597-98 2598-99 2599-00 2600-01 2601-02 2602-03 2603-04 2604-05 2605-06 2606-07 2607-08 2608-09 2609-10 2610-11 2611-12 2612-13 2613-14 2614-15 2615-16 2616-17 2617-18 2618-19 2619-20 2620-21 2621-22 2622-23 2623-24 2624-25 2625-26 2626-27 2627-28 2628-29 2629-30 2630-31 2631-32 2632-33 2633-34 2634-35 2635-36 2636-37 2637-38 2638-39 2639-40 2640-41 2641-42 2642-43 2643-44 2644-45 2645-46 2646-47 2647-48 2648-49 2649-50 2650-51 2651-52 2652-53 2653-54 2654-55 2655-56 2656-57 2657-58 2658-59 2659-60 2660-61 2661-62 2662-63 2663-64 2664-65 2665-66 2666-67 2667-68 2668-69 2669-70 2670-71 2671-72 2672-73 2673-74 2674-75 2675-76 2676-77 2677-78 2678-79 2679-80 2680-81 2681-82 2682-83 2683-84 2684-85 2685-86 2686-87 2687-88 2688-89 2689-90 2690-91 2691-92 2692-93 2693-94 2694-95 2695-96 2696-97 2697-98 2698-99 2699-00 2700-01 2701-02 2702-03 2703-04 2704-05 2705-06 2706-07 2707-08 2708-09 2709-10 2710-11 2711-12 2712-13 2713-14 2714-15 2715-16 2716-17 2717-18 2718-19 2719-20 2720-21 2721-22 2722-23 2723-24 2724-25 2725-26 2726-27 2727-28 2728-29 2729-30 2730-31 2731-32 2732-33 2733-34 2734-35 2735-36 2736-37 2737-38 2738-39 2739-40 2740-41 2741-42 2742-43 2743-44 2744-45 2745-46 2746-47 2747-48 2748-49 2749-50 2750-51 2751-52 2752-53 2753-54 2754-55 2755-56 2756-57 2757-58 2758-59 2759-60 2760-61 2761-62 2762-63 2763-64 2764-65 2765-66 2766-67 2767-68 2768-69 2769-70 2770-71 2771-72 2772-73 2773-74 2774-75 2775-76 2776-77 2777-78 2778-79 2779-80 2780-81 2781-82 2782-83 2783-84 2784-85 2785-86 2786-87 2787-88 2788-89 2789-90 2790-91 2791-92 2792-93 2793-94 2794-95 2795-96 2796-97 2797-98 2798-99 2799-00 2800-01 2801-02 2802-03 2803-04 2804-05 2805-06 2806-07 2807-08 2808-09 2809-10 2810-11 2811-12 2812-13 2813-14 2814-15 2815-16 2816-17 2817-18 2818-19 2819-20 2820-21 2821-22 2822-23 2823-24 2824-25 2825-26 2826-27 2827-28 2828-29 2829-30 2830-31 2831-32 2832-33 2833-34			

[fol. 96]

IN UNITED STATES DISTRICT COURT

EXHIBIT D TO COMPLAINT

[fol. 97]

J. FRANK CONNOR, INC.,
c/o THE HERTZ CORPORATION,
218 South Wabash Avenue,
Chicago 4, Illinois.

**A STATEMENT ATTACHED TO AND MADE PART OF CLAIM FOR
REFUND OF INCOME TAX FOR FISCAL YEAR ENDED MARCH
31, 1955**


[COPY]

Pursuant to Revenue Ruling 54-17, 1954-1 CB 160, this claim for refund is filed by The Hertz Corporation, a Delaware corporation, in the name of and on behalf of J. Frank Connor, Inc., a New Jersey corporation, said J. Frank Connor, Inc., having been merged, by statutory merger under the Delaware General Corporation Law and Title 14 of the Revised Statutes of New Jersey, into said The Hertz Corporation on July 5, 1956. In accordance with Revenue Ruling 54-17, there are attached hereto: (a) a copy of the Certificate of Ownership merging J. Frank Connor, Inc., into The Hertz Corporation, duly certified by the Secretary of State of the State of Delaware, and (b) a copy of the Agreement of Merger between The Hertz Corporation and J. Frank Connor, Inc., duly certified by the Secretary of State of the State of New Jersey.

On or about June 15, 1955, J. Frank Connor, Inc., filed its U.S. Corporation Income Tax Return for its fiscal year ended March 31, 1955. On that return, the Taxpayer claimed \$14,737.34 as a depreciation deduction with respect to new automobiles acquired by the Taxpayer after December 31, 1953, the original use of which automobiles commenced [fol. 98] with the Taxpayer and commenced after such date. Said depreciation deduction for automobiles was computed on the basis of a four (4) year life, using rates of thirty per cent (30%) for each of the first two years and twenty per cent (20%) for each of the last two years. In addition, the Taxpayer on that return claimed \$3,607.78 as a depreciation deduction with respect to new trucks acquired by the Taxpayer after December 31, 1953, the original use of which trucks commenced with the Taxpayer and commenced after such date. Said depreciation deduction for trucks was com-


puted on a straight line basis using useful lives as follows: vans and heavy-duty trucks—five (5) years; other trucks—four (4) years; however, trucks acquired after December 31, 1953, but prior to April 1, 1954, were depreciated at the rate of three cents (\$.03) per milé.

This claim for refund is filed for the purpose of changing the Taxpayer's election to compute depreciation on said automobiles and trucks for its fiscal year ended March 31, 1955, from the above-mentioned methods to an election to compute depreciation on said automobiles and trucks for its fiscal year ended March 31, 1955, on the declining balance method, using a rate of two hundred per cent (200%) of the straight line rate, as permitted under Section 167 of the 1954 Internal Revenue Code. Accordingly, the Taxpayer hereby makes such change of election, pursuant to Regulation 1-167(c)-1(★) of the Income Tax Regulations under the 1954 Internal Revenue Code, and hereby makes claim for refund of income tax paid for its fiscal year ended March 31, 1955, in the amount of \$4,044.54 (together with [fol. 99] applicable interest thereon), which amount the Taxpayer has computed as follows:

(See Opposite) 

	Automobiles	Trucks	Total
Depreciation claimed per return on new automobiles and trucks acquired by taxpayer after December 31, 1953, original use of which commenced with taxpayer after such date			
Depreciation on said items using declining balance method at 200% of straight line rate	\$14,737.34	\$3,607.78	\$18,345.12
Additional depreciation allowable	24,611.36	7,215.56	31,826.92
Less increase in capital gains attributable to use of declining balance method at 200% of straight line rate	9,874.02	3,607.78	13,481.80
Reduction of taxable income	0	0	0
	9,874.02	3,607.78	13,481.80
Tax reduction at applicable rates			
For additional depreciation allowable			\$4,044.54
Less increase in capital gain tax			0
Net tax reduction			\$4,044.54

EXHIBIT E TO COMPLAINT

(See Opposite) 

[fol. 100]

IN UNITED STATES DISTRICT COURT

EXHIBIT E TO COMPLAINT

U. S. TREASURY DEPARTMENT - INTERNAL REVENUE SERVICE		Stamp (Revenue's Stamp) (Date received)
CLAIM		
TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSIGNMENT WAS MADE ON TAX PAID		
<input type="checkbox"/> Refund of Taxes Illegally, Unlawfully, or Excessively Collected <input type="checkbox"/> Refund of Amount Paid for Stamps Overpaid, or Used in Error or Excess <input type="checkbox"/> Allowance of Tax Amounted (not applicable to estate, gift, or income taxes)		
PLEASE TYPE OR PRINT PLAINLY		
Name of taxpayer or producer of stamp J. MARK GREEN, JR.		
Number and street City, town, postal zone, State 40 The North Commercial, and South Market Avenue, Chicago 4, Illinois		
1. Current or claim return of day was filed March 2, 1935		
2. Name and address shown on return, if different from above 40 State Street March 2, New Jersey		
3. Period: If for tax reported on annual basis, prepare separate form for each taxable year From April 1, 1934 To March 31, 1935		
4. Kind of tax Income tax		
5. Amount of assessment 17,322.50		
6. Date of payment June 2, 1935, and September 11, 1935		
7. Tax stamps were purchased from the Government Not applicable		
8. Amount to be abated (not applicable to income, estate, or gift taxes) Not applicable		
9. The claimant believes that this claim should be allowed for the following reasons:		

(See taxpayer's statement attached
hereto and made a part hereof.)

Use reverse if space is not sufficient.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been prepared by me and to the best of my knowledge and belief to true and correct.

Signed

J. MARK GREEN, JR.
By **WILLIAM A. PETRE**

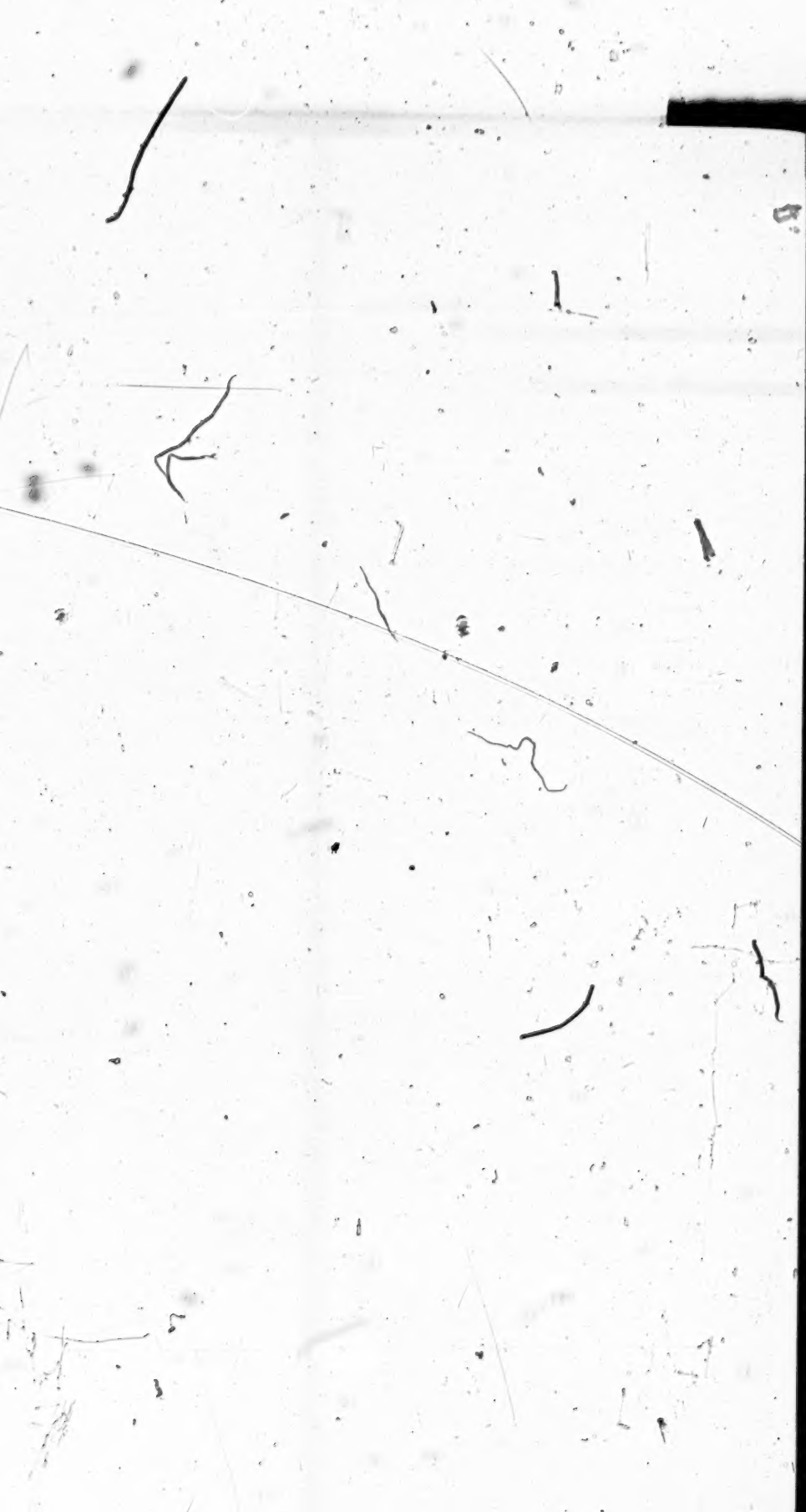
Date **September 11, 1935** **WILLIAM A. PETRE**

INSTRUCTIONS

1. The claim must not form in itself each ground upon which it is made and facts sufficient to apprise the Commissioner of the exact basis thereof.
2. If a joint income tax return was filed for the year for which the claim is filed, both husband and wife must sign this claim even though only one had income.
3. Whenever it is necessary to have the claim executed by an agent on behalf of the taxpayer, an authenticated copy of the document specifically authorizing such agent to sign the claim on behalf of the taxpayer must accompany the claim.
4. If a return is filed by an individual and a related claim is thereafter filed by a legal representative of the deceased, the cause of the former representative, letters of administra-

tion, or other similar evidence, must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made on the claim showing that the return was filed by the fiduciary and that the latter is still acting.

5. Where the taxpayer is a corporation, the claim will be signed with the corporate name, followed by the signature and title of the officer having authority to sign for the corporation.



[fol. 100]

IN UNITED STATES DISTRICT COURT

EXHIBIT E ~~TO~~ COMPLAINT

[fol. 101]

J. FRANK CONNOR, INC.,
c/o THE HERTZ CORPORATION,
218 South Wabash Avenue,
Chicago 4, Illinois.

A STATEMENT ATTACHED TO AND MADE PART OF CLAIM
FOR REFUND OF INCOME TAX FOR FISCAL YEAR ENDED
MARCH 31, 1956

[COPY]

Pursuant to Revenue Ruling 54-17, 1954-1 CB 160, this claim for refund is filed by The Hertz Corporation, a Delaware corporation, in the name of and on behalf of J. Frank Connor, Inc., a New Jersey corporation, said J. Frank Connor, Inc., having been merged, by statutory merger under the Delaware General Corporation Law and Title 14 of the Revised Statutes of New Jersey, into said The Hertz Corporation on July 5, 1956. In accordance with Revenue Ruling 54-17, there are attached hereto: (a) a copy of the Certificate of Ownership merging J. Frank Connor, Inc., into The Hertz Corporation, duly certified by the Secretary of State of the State of Delaware, and (b) a copy of the Agreement of Merger between The Hertz Corporation and J. Frank Connor, Inc., duly certified by the Secretary of State of the State of New Jersey.

On or about June 5, 1956, J. Frank Connor, Inc., filed its U.S. Corporation Income Tax Return for its fiscal year ended March 31, 1956. On that return, the Taxpayer claimed \$46,892.12 as a depreciation deduction with respect to new automobiles acquired by the Taxpayer after December 31, 1953, the original use of which automobiles commenced with the Taxpayer and commenced after such [fol. 102] date. Said depreciation deduction for automobiles was computed on the basis of a four (4) year life, using rates of thirty per cent (30%) for each of the first two years and twenty per cent (20%) for each of the last two years. In addition, the Taxpayer on that return claimed \$5,721.99 as a depreciation deduction with respect to new trucks acquired by the Taxpayer after December 31, 1953, the original use of which trucks commenced with the Tax-

payer and commenced after such date. Said depreciation deduction for trucks was computed on a straight-line basis using useful lives as follows: vans and heavy-duty trucks—five (5) years; other trucks—four (4) years; however, trucks acquired after December 31, 1953,* but prior to April 1, 1954, were depreciated at the rate of three cents (\$.03) per mile.

This claim for refund is filed for the purpose of changing the Taxpayer's election to compute depreciation on said automobiles and trucks for its fiscal year ended March 31, 1956, from the above-mentioned methods to an election to compute depreciation on said automobiles and trucks for its fiscal year ended March 31, 1956, on the declining balance method, using a rate of two hundred per cent (200%) of the straight line rate, as permitted under Section 167 of the 1954 Internal Revenue Code. Accordingly, the Taxpayer hereby makes such change of election, pursuant to Regulation 1.167(c)-1(c) of the Income Tax Regulations under the 1954 Internal Revenue Code, and hereby makes claim for refund of income tax paid for its fiscal year ended March 31, 1956, in the amount of \$10,416.43 (to- [fol. 103] gether with applicable interest thereon), which amount the Taxpayer has computed as follows:

	Automobiles	Trucks	Total
Depreciation claimed per return on new automobiles and trucks acquired by taxpayer after December 31, 1953, original use of which commenced with taxpayer after such date.....	\$46,892.12	\$5,721.99	\$52,614.11
Depreciation on said items using declining balance method at 200% of straight line rate.....	78,313.00	11,444.00	89,757.00
Additional depreciation allowable.....	31,420.88	5,722.01	37,142.89
Less increase in capital gains attributable to use of declining balance method at 200% of straight line rate.....	17,301.49	1,197.00	18,498.49
Reduction of taxable income.....	14,119.39	4,525.01	18,644.40

Tax reduction at applicable rates:

For additional depreciation allowable.....	\$18,270.40
Less increase in capital gain tax.....	2,853.97

Net tax reduction..... 10,416.43

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

THE HERTZ CORPORATION, A CORPORATION (SUCCESSOR BY
MERGER TO J. FRANK CONNOR, INC., A CORPORATION),
Plaintiff,

v.

UNITED STATES OF AMERICA, Defendant.

STIPULATION OF FACTS

Plaintiff and Defendant, by their respective attorneys, hereby stipulate to the following facts for the purposes of this proceeding, all statements herein, subject only to objections by either of the parties hereto for irrelevance or immateriality, to be taken as true and admitted, and without prejudice to the right of either party to offer additional evidence not inconsistent therewith.

1. The Plaintiff, The Hertz Corporation, a corporation (herein sometimes referred to as "Hertz"), is the successor [fol. 104] by merger to J. Frank Connor, Inc., a corporation (herein sometimes referred to as "Connor"), which latter corporation was organized under the laws of the State of New Jersey on April 2, 1947.

2. At all times material herein, Connor was on the accrual basis of accounting.

3. Hertz is a corporation duly organized and existing under the laws of the State of Delaware, and its principal office in the State of Delaware is located at No. 100 West Tenth Street, Wilmington, Delaware.

4. Connor was merged into Hertz on July 5, 1956, by duly consummated statutory merger in accordance with the Delaware General Corporation Law and the Revised Statutes of New Jersey.

5. By operation of law, all the property of Connor and Hertz, and all debts due to either, and all choses in action

and interests of either of said corporations became vested in Hertz, as the surviving corporation, upon the effectuation of said merger, including the right of Connor to file the claims for refund of tax hereinafter described, and to make the elections in said claims and to recover the overpayments, if any, of taxes as alleged in the Complaint heretofore filed herein.

6. On or about June 11, 1954, Connor duly filed its United States Corporation Income Tax Return for its fiscal year ended March 31, 1954, with the District Director of Internal Revenue in Newark, New Jersey, reporting income tax in the amount of \$18,983.13. Such tax was duly paid on or about the dates and in the amounts shown in the following table:

<i>Date</i>	<i>Amount</i>
June 11, 1954	\$8,547.41
September 14, 1954	8,547.41
December 4, 1954	944.16
March 9, 1955	944.15
Total	18,983.13

[fol. 105] 7. On or about June 10, 1955, Connor duly filed its United States Corporation Income Tax Return for its fiscal year ended March 31, 1955 with the District Director of Internal Revenue in Newark, New Jersey, reporting income tax in the amount of \$3,894.50. Total tax for said fiscal year in the amount of \$4,644.50 was duly paid on or about the dates and in the amounts shown in the following table:

<i>Date</i>	<i>Amount</i>
June 10, 1955	\$1,947.25
September 12, 1955	1,947.25
May 15, 1956	750.00
Total	4,644.50

8. On or about June 11, 1956, Connor duly filed its United States Corporation Income Tax Return for its

fiscal year ended March 31, 1956, with the District Director of Internal Revenue in Newark, New Jersey, reporting income tax in the amount of \$17,550.94. Such tax was duly paid on the dates and in the amounts shown in the following table:

<i>Date</i>	<i>Amount</i>
June 13, 1956	\$8,775.47
September 13, 1956	8,775.47
Total	17,550.94

9. *On or about the dates indicated hereinbelow, there were duly filed with the District Director of Internal Revenue in Newark, New Jersey, claims for refund of income tax (copies of which are set forth in the Complaint heretofore filed herein, as Exhibits C, D and E), said claims being as follows:

(a) on or about September 14, 1956, a claim for refund of income tax with respect to Connor's fiscal year ended March 31, 1954, in the amount of \$100.15;

(b) on or about September 14, 1956, a claim for refund of income tax with respect to Connor's [fol. 106] fiscal year ended March 31, 1955, in the amount of \$4,044.54; and

(c) on or about September 17, 1956, a claim for refund of income tax with respect to Connor's fiscal year ended March 31, 1956, in the amount of \$10,416.43.

10. No decision has been rendered on said claims for refund and more than six months have passed since the date of filing of said claims, and Plaintiff was therefore authorized to bring the above entitled suit to recover the taxes covered by said claims.

11. Connor at all times material herein was engaged in the State of New Jersey, in the business of renting on an hourly, daily or other short term basis, and leasing on a longer term basis, automobiles and trucks without drivers.

12. Subsequent to December 31, 1953, Connor purchased new automobiles and trucks for use in its business during its fiscal years ended March 31, 1954, March 31, 1955, and March 31, 1956.

13. The Income Tax Returns filed by Connor for its fiscal years ended March 31, 1954, March 31, 1955 and March 31, 1956 are attached hereto as Exhibits A, B and C, respectively.

14. In its claims for refund of income taxes (copies of which are set forth as Exhibits C, D and E in the Complaint heretofore filed herein), Connor duly made its election to use the declining balance method in computing depreciation deductions with respect to said automobiles and trucks for said fiscal years, using a rate of 200% of the straight-line rate in lieu of the depreciation deductions claimed on Connor's said income tax returns. Said election was made in accordance with Reg. 1.167(c)-1(c) of the Income Tax Regulations issued under the Internal Revenue Code of 1954.

[fol. 107] 15. The facts set forth in Exhibit D attached hereto are a part of this Stipulation.


16. If the Court should find for the Plaintiff, in whole or in part, the question of the amount of the refund will be left to the agreement of the parties upon recomputation, and if the parties are unable to agree, the question will be submitted to the Court upon further hearing.

EXHIBIT D

The following list covers all automobiles and trucks acquired new by J. Frank Connor, Inc., after December 31, 1953, with respect to which accelerated depreciation is claimed at any time during Connor's fiscal years ended March 31, 1954, March 31, 1955 and March 31, 1956.

Said list does not include automobiles and trucks acquired by J. Frank Connor, Inc. prior to January 1, 1954, since the taxpayer does not claim accelerated depreciation as to those vehicles.

Dates of sale, as shown on said list, include sales through February 28, 1958.

(See Opposite) 

J. FRANK CONNOR, INC.

DEPRECIATION DATA

AUTOMOBILES

Vehicle No.	Make	Motor No.	Date		Months held	Cost	Selling price
			Pur- chased	Sold			
255	Chevrolet	0168742554	3-8-54	10-1-55	19	1,881.40	1,100.00
257	do	017780T	3-19-54	1-27-56	22	1,892.64	925.00
258	do	0102179T	2-3-54	1-19-56	23	1,725.14	955.00
268	do	0053304T	1-6-54	12-29-55	23	1,801.40	955.00
221	do	0007609T544	3-15-54	12-1-55	20	1,763.00	850.00
255	do	0158044T544	3-15-54	11-15-55	20	1,925.00	1,000.00
260	do	0155834	3-6-54	11-21-55	20	1,725.14	950.00
229	do	01080845	2-3-54	11-2-55	21	1,801.40	1,000.00
241	do	00678045	2-3-54	12-27-55	21	1,725.14	915.00
245	do	0211415T	4-2-54	11-1-55	19	1,881.40	1,100.00
213	do	0193347T	4-2-54	10-12-55	18	1,881.40	1,100.00
204	do	0198072T	4-2-54	11-29-55	19	1,881.40	900.00
214	do	0197211T	4-30-54	11-29-55	19	1,846.72	900.00
218	do	0220158T	4-29-54	12-6-55	20	1,846.72	900.00

DEPRECIATION DATA—Continued
AUTOMOBILES—Continued

Vehicle No.	Make	Motor No.	Date		Months held	Cost	Selling price
			Pur- chased	Sold			
215	Chevrolet	0102 11T	4-29-54	11-29-55	19	1,535.79	935.00
	do	0199488T	5-10-54	12-21-55	20	1,538.14	905.00
	do	021106T	5-12-54	12-27-55	18	1,538.14	900.00
	do	0257292T	5-14-54	11-7-55	17	1,598.02	900.00
206	Mercury	54ME4211	6-1-54	4-13-57	34	2,120.00	980.00
	Ford	A4EO146863	6-7-54	12-28-55	18	1,886.02	815.00
	do	A4EO147716	6-2-54	12-6-55	12	1,704.00	900.00
226	Oldsmobile	V180459	6-11-54	2-14-56	20	2,622.13	1,200.22
	Ford	A4EO147722	6-15-54	1-18-56	19	1,864.98	775.00
	Chevrolet	0315486	6-17-54	1-23-56	19	1,877.25	960.00
	do	0197139	6-21-54	11-15-55	17	1,877.25	965.00
	do	B54T088282	7-2-54	1-5-56	18	1,852.25	1,000.00
	do	B54T115738	7-2-54	11-29-55	16	1,713.42	900.00
	do	B54T116370	7-2-54	1-18-56	18	1,834.14	945.00
	do	B54T124974	7-2-54	1-27-56	18	1,690.04	900.00
	do	B54T117105	7-8-54	1-13-56	18	1,700.00	900.00
208	Oldsmobile	547L5101	7-8-54	2-14-56	19	2,622.13	1,200.22
217	Chevrolet	001420T	11-17-54	11-20-56	24	1,963.00	1,075.00
211	do	0064254	12-9-54	11-1-56	23	1,963.00	975.00
216	do	0060919	12-6-54	11-1-56	23	2,145.00	1,050.00
219	do	0071949	12-22-54	12-5-56	24	2,134.00	1,050.00
206	do	0107515	1-24-55	11-1-56	22	1,718.00	700.00
201	do	B55T075800	2-4-55	11-20-56	21	1,968.00	1,050.00
202	do	C56T048544	12-21-55	12-5-56	12	2,140.00	1,550.00
203	do	C56T033648	3-30-56	10-2-57	19	1,969.00	950.00
204	do	C56T033987	11-29-55	12-5-56	13	2,141.00	1,550.00
205	Ford	M6ET144912	1-13-56	1-18-57	12	2,226.00	1,550.00
206	do	V6CX151611	6-30-55	1-2-57	19	2,413.00	1,000.00
207	Chevrolet	0228256	4-22-55	11-1-56	19	1,950.00	1,075.00
208	do	022867	4-20-55	11-20-56	19	1,950.00	1,075.00
209	do	0223864	4-20-55	11-20-56	19	1,960.00	1,075.00
210	do	048584	12-21-55	1-15-57	13	2,140.00	1,550.00
212	do	049632	12-27-55	1-2-57	13	2,117.00	1,475.00
213	Ford	103247	10-12-55	12-7-56	14	2,288.00	1,500.00
214	Chevrolet	012540	11-29-55	1-15-57	14	2,141.00	1,550.00
215	do	022918	11-29-55	11-23-56	12	2,150.00	1,550.00
216	do	020687	12-6-55	1-15-57	13	2,160.00	1,400.00
220	do	0231279	4-19-55	11-16-56	19	1,950.00	1,075.00
221	do	034088	12-6-55	12-5-56	12	2,138.00	1,550.00
222	do	180789	7-5-55	11-20-56	16	1,945.00	1,075.00
223	do	19095	6-29-55	12-5-56	18	2,880.00	1,200.00
224	Ford	173363	6-17-55	12-3-56	18	1,832.00	975.00
225	Chevrolet	004612	11-1-55	1-19-57	14	2,160.00	1,550.00
226	do	140135	5-28-55	12-5-56	19	1,945.00	1,025.00
227	do	154464	5-23-55	11-20-56	18	1,945.00	1,025.00
228	Ford	150983	6-18-55	11-1-56	18	1,862.00	975.00
229	do	173067	6-14-55	11-23-56	17	2,008.00	1,025.00
230	Chevrolet	012730	11-7-55	1-26-57	14	1,967.00	1,450.00
231	do	0231509	4-20-55	11-20-56	19	1,950.00	1,075.00
232	do	0231492	4-20-55	8-23-56	16	1,950.00	-----
233	do	153569	6-28-55	11-20-56	17	1,785.00	950.00
234	do	023140	11-15-55	1-2-57	14	2,120.00	1,550.00
235	Pontiac	19650	6-29-55	12-6-56	18	2,854.00	1,150.00
237	Ford	123124	12-6-55	12-5-56	12	2,206.00	1,000.00

Retired at book value—wrecked.

DEPRECIATION DATA—Continued
AUTOMOBILES—Continued

Vehicle No.	Make	Motor No.	Date		Months held	Cost	Selling price
			Pur- chased	Sold			
238	Chevrolet	126786	5-25-55	11-21-56	18	1,808.00	900.00
239	do	010854	11-2-55	1-15-57	14	2,048.00	1,600.00
240	do	0240809	11-21-55	1-15-57	14	2,120.00	1,600.00
241	do	049844	12-31-55	1-15-57	13	2,117.00	1,575.00
242	do	043412	12-28-55	1-2-57	13	2,025.00	1,280.00
243	do	157575	5-25-55	11-1-56	19	1,820.00	1,000.00
244	do	074037	6-29-55	11-1-56	17	1,945.00	
245	Ford	107209	11-1-55	12-5-56	13	2,311.00	1,300.00
	Chevrolet	055510	3-29-56	10-12-57	19	2,161.00	1,100.00
247	do	055004	1-15-56	12-5-56	11	2,145.00	1,550.00
248	do	013018	1-22-56	1-2-57	12	2,174.00	1,575.00
249	do	154972	6-29-55	12-5-56	18	1,945.00	1,050.00
250	do	022070	11-15-55	12-12-56	13	2,142.00	1,575.00
251	do	085116	1-27-56	1-15-57	12	2,151.00	1,550.00
252	do	050880	1-5-56	11-21-56	10	2,121.00	1,600.00
253	do	174188	7-7-55	11-21-56	16	1,985.00	1,075.00
254	do	049530	1-18-56	1-15-57	12	2,151.00	1,550.00
255	Ford	112915	10-18-55	1-15-57	15	2,288.00	1,500.00
256	Chevrolet	029070	11-29-55	12-12-56	13	2,145.00	1,600.00
257	do	051129	1-27-56	12-12-56	11	2,145.00	1,575.00
258	do	053880	1-19-56	1-15-57	12	2,122.00	1,600.00
259	Ford	144914	1-13-56	1-15-57	12	2,203.00	1,500.00
260	do	161535	6-12-55	11-21-56	18	2,010.00	1,025.00
261	do	177264	7-13-55	6-27-56	11	2,010.00	750.00
262	do	177593	7-13-55	11-21-56	16	2,010.00	1,025.00
263	Chevrolet	150051	7-13-55	11-21-56	16	1,787.00	850.00
264	do	195284	7-13-55	12-12-56	17	1,765.00	950.00
265	Ford	177507	6-30-55	11-21-56	17	2,011.00	1,025.00
266	do	177505	6-30-55	12-12-56	18	2,011.00	1,050.00
267	do	176880	6-30-55	12-12-56	18	2,033.00	1,050.00
268	Chevrolet	050085	12-29-55	1-15-57	13	2,122.00	1,550.00
269	do	111053	5-12-55	11-1-56	18	1,975.00	1,050.00
270	Ford	173731	6-3-55	11-21-56	17	2,017.00	1,025.00
271	do	172088	6-3-55	12-12-56	18	2,008.00	1,050.00
272	Chevrolet	020073	12-5-55	10-2-57	22	2,050.00	975.00
273	do	154471	6-21-55	11-21-56	17	1,948.00	1,050.00
274	do	137893	6-22-55	11-1-56	17	1,948.00	1,050.00
275	Ford	170782	5-18-55	11-1-56	18	2,019.00	1,050.00
276	Chevrolet	044524	1-25-56	10-2-57	21	2,230.00	1,075.00
277	do	145342	5-11-55	11-1-56	18	1,987.00	900.00
278	Ford	179712	6-16-55	12-5-56	18	2,019.00	1,025.00
280	do	173351	6-12-55	11-1-56	17	1,854.00	1,025.00
281	Chevrolet	135626	5-25-55	11-21-56	18	1,945.00	1,075.00
282	Ford	154316	4-25-55	11-1-56	19	2,008.00	1,075.00
283	do	159803	5-25-55	9-27-56	16	2,008.00	1,100.00
284	Chevrolet	120084	7-7-55	12-5-56	17	1,973.00	1,025.00
285	Ford	126468	6-20-55	11-1-56	17	2,033.00	1,100.00
287	Chevrolet	141208	6-28-55	11-12-56	17	1,785.00	975.00
288	Ford	176708	6-16-55	12-5-56	18	2,011.00	1,025.00
289	Chevrolet	0234140	4-20-55	11-1-56	19	1,950.00	1,100.00
290	do	125195	6-28-55	11-21-56	17	1,945.00	1,075.00
291	do	174229	7-6-55	11-12-56	16	1,953.00	1,075.00
292	do	200500	8-2-55	12-5-56	16	1,810.00	975.00

¹ Retired at book value—wrecked.

[fol. 110]

DEPRECIATION DATA—Continued
AUTOMOBILES—Continued

Vehicle No.	Make	Motor No.	Date		Months held	Cost	Selling price
			Pur-chased	Sold			
293	Chevrolet	174120	8-2-55	11-21-56	15	1,975.00	1,075.00
294	do	203398	8-5-55	12-5-56	16	1,932.00	975.00
295	do	203082	8-2-55	11-1-56	15	1,932.00	1,100.00
296	do	203008	8-5-55	11-1-56	15	1,932.00	1,050.00
300	Pontiac	12012	2-14-56	12-12-57	22	2,466.00	1,300.00
301	do	12006	2-14-56	9-30-57	19	2,466.00	1,300.00
302	Chevrolet	09556	3-22-56	10-12-57	19	2,138.00	1,225.00
301	do	108275	3-22-56	3-28-57	12	2,138.00	-----
301	Pontiac	12485	2-29-56	-----	24	3,757.00	-----

TRUCKS

Vehicle No.	Make	Motor No.	Date		Months held	Cost	Selling price
			Pur-chased	Sold			
(2000) 78	Chevrolet	0100177T	1-28-54	On hand	49	1,719.94	-----
79	G.M.C.	F-248220357	2-11-54	2-16-57	36	2,050.00	-----
(1622) 42	G.M.C.	A2708269	4-14-54	10-22-56	30	4,668.44	3,125.52
(2001) 63	G.M.C.	A248231903	5-3-54	On hand	45	4,378.00	-----
(2000) 63	G.M.C.	A248220086	5-3-54	On hand	45	4,378.00	-----
	G.M.C.	A248240943	7-9-54	5-16-55	10	2,633.54	2,852.37
	G.M.C.	A23828092	7-8-54	5-16-55	10	2,631.65	2,863.60
	G.M.C.	A248240918	7-8-54	5-16-55	10	2,814.65	2,904.42
(2003) 66	G.M.C.	F26374	12-30-54	On hand	38	2,660.00	-----
(2007) 77	Chevrolet	W55T011681	2-17-55	On hand	36	2,322.00	-----
(2005) 19	do	027214	8-3-55	On hand	30	1,563.00	-----
(2007) 30	do	006079	4-25-55	On hand	34	2,854.00	-----
(2005) 28	do	024921	8-22-55	On hand	30	3,612.00	-----
(2001) 72	do	025863	8-22-55	On hand	30	3,612.00	-----
(2005) 88	do	033006	10-5-55	9-14-57	23	3,542.00	2,657.51
(2017) 48	do	038371	12-16-55	On hand	26	3,623.00	-----
(2023) 54	do	028000	12-16-55	On hand	26	2,850.00	-----
(2004) 68	do	001631	2-14-56	On hand	24	2,258.00	-----
(2000) 73	do	002144	2-14-56	On hand	24	3,490.00	-----

¹ Retired at book value—wrecked.

² Holding period of trucks on hand as at February 28, 1958.

³ Holding period of car on hand as at February 28, 1958.

IN UNITED STATES DISTRICT COURT
PLAINTIFF'S EXHIBIT 2

J. FRANK CONNOR, INC.

HOLDING PERIOD IN MONTHS OF VEHICLES SOLD YEARS ENDED MARCH 31, 1948-56

Year ended March 31—	Number of vehicles	Holding period in months		
		Average	Longest	Shortest
Cars:				
1948	20	52	81	31
1949	6	26	45	19
1950	27	26	60	17
1951	13	27	29	34
1952	24	34	52	30
1953	25	26	35	24
1954	28	32	67	21
1955	12	30	39	23
1956	66	23	51	16
Trucks:				
1948	6	73	90	36
1949	4	34	79	17
1950	12	53	101	34
1951	18	49	71	34
1952	14	47	87	26
1953	14	50	60	11
1954	5	23	24	21
1955	4	45	51	32
1956	9	45	85	10

IN UNITED STATES DISTRICT COURT

OPINION—July 17, 1958

LAYTON, *District Judge.*

This is an action for the refund of federal income taxes paid by J. Frank Connor, Inc., a New Jersey corporation, and the plaintiff's predecessor by merger, for its fiscal years ended March 31, 1954, 1955 and 1956. The aggregate amount claimed is \$14,561.12, as follows:

Year ended March 31:		<i>Income tax</i>
1954	\$100.15
1955	4,044.54
1956	10,416.43
		<hr/>
		14,561.12

[fol. 112] This litigation arises under the Internal Revenue Code of 1954 (Section 7422, Title 26, United States Code) and under Title 28, United States Code, Sections 1340 and 1346(a)(1), as amended.

The plaintiff takes the position that it is entitled, under Section 167(b)(2) of the Internal Revenue Code of 1954, to depreciate the automobiles and trucks purchased new after December 31, 1953, and used in its vehicle renting and leasing business, under the declining-balance method, using a rate of 200% of the straight line rate, that is, with respect to automobiles, 50% annually by the declining-balance, over a four year useful life.

These are the facts.

Connor, organized as a New Jersey corporation on April 2, 1947, was merged into the plaintiff on July 5, 1956, by a duly consummated statutory merger under the Delaware General Corporation Law and the Revised Statutes of New Jersey. The plaintiff, a Delaware corporation, thus became entitled to file the claims for refund of federal income tax which are the subject matter of the case at bar.

At all times material to this case, Connor was engaged in the State of New Jersey in the business of renting and leasing automobiles and trucks without drivers. "Renting" is the term used in the industry to describe the hiring of

vehicles by salesmen, executives, engineers and tourists on a relatively short-term basis at the stipulated rates per mile and per hour or per day. "Leasing" is the term used in the industry to describe the contract hiring of vehicles for a fixed period on a relatively long-term basis (for example, by the year or longer period).

During the three taxable years in question, Connor had a preventive maintenance program to keep its cars safely on the road and mechanically in good condition. At 1,000 miles, for example, examination was made of certain parts of the vehicle, such as steering, brakes and so on. At 2,000 miles or 3,000 miles, the vehicles were given another examination for other safety factors. And at 6,000 miles, there was another mechanical inspection and, in fact, a constant system of inspection was kept in force as long as Connor owned the vehicles.

Connor's cars were regularly serviced, as any other owner might service them, by greasing, oiling, keeping the tires in good repair and the like. For example, cars were greased or lubricated regularly at the 1,000 or 1,500-mile point, mileage records being kept of each individual car. The factors affecting Connor's decision to buy and sell automobiles were not always predictable. Moreover, sales and purchases of automobiles by Connor did not necessarily accompany each other. One factor which governed Connor's decision as to when to buy cars was the public demand for Connor's service. In this connection, the influence of recession or prosperity had a marked effect on Connor's business. In a recession or slowdown in production, the engineer, salesman or executive does not make as many calls, work forces are being reduced, and the sources of U-Drive-It business are affected. Connor depended a great deal on the out-of-town businessman who would come to Newark, rent a vehicle while there, make his calls and return to his place of business by other means, plane or train.

Business conditions in Connor's immediate vicinity had an effect on its business. For example, since it depended on local people to rent its trucks, a slowdown in Connor's vicinity would cause it to have a surplus of trucks which [fol. 114] it would have to dispose of. In connection with

these considerations, in determining when to acquire or dispose of cars, Connor was motivated among other things by whether it was operating a substantial part of its fleet.

What Connor's competitors did had a great influence on its decisions about purchases of automobiles. If competitors were renting certain types of automobiles and those types were what the public demanded, Connor would have to do the same and keep up with the demand. This was only one of the factors which had to be taken into consideration in deciding when and whether to buy and sell cars.

In addition, the advent of mechanical changes in cars was an unpredictable factor in influencing Connor's sales and purchases of automobiles. Thus, when automatic transmission was introduced, many people wanted to rent automobiles which embodied that innovation. However, it was also true that a great many drivers who had been operating the conventional shift for years were reluctant to drive cars with automatic transmission, being fearful that such transmission would not take them up a hill—that it was not quite powerful enough. Connor was thus forced to keep both types of vehicles on hand.

Strikes and lockouts also had an effect on Connor's decisions with respect to purchases and sales of automobiles. Work stoppages, when the conveyors carrying vehicles from the factory were on strike, might cause a delay of months in moving out old vehicles because Connor was forced to hold on to its old equipment until it could expand with new vehicles.

Whether the country was at war or at peace had a great influence on Connor's decisions as to whether to buy or to sell vehicles.

Unexpected climatic conditions also had effect on Connor's timing in buying and selling. For example, in a [fol. 115] disaster in New England when the telephone lines were down, one of its accounts, a telephone company, called and reported that it had to send hundreds of people into the affected area to repair the lines. There was a great demand for cars and the cars used for this purpose were used for a long period of time. This situation warranted Connor's purchasing additional vehicles to supply its transient trade in the interim.

When the Newark Airport was opened in 1951, a new and unexpected influence on Connor's car purchasing and selling decisions developed. Connor never anticipated that the airport would produce a great deal of vehicle renting business. In 1952, it had a bad experience in Newark when the Newark Airport was closed down after a few disasters there. There were no rentals at all. However, when the Newark Airport reopened, it obtained an excellent location within the Airport terminal and started expanding its airport business from that point. Within a year there was an increase of approximately sixty cars in its fleet. This was an unusual increase, Connor never having anticipated that volume of business from such an inconvenient location.

One of the more isolated reasons why Connor sold cars during the period in question was its financial situation. At one time, Connor had to sell automobiles to meet a bank loan; at another, to pay off finance notes; and, at still another, to pay the rent. None of the facts enumerated above was predictable in advance.

Under the influence of all of these factors, the periods during which Connor held automobiles and trucks used in its renting and leasing business varied considerably, not only during the taxable years under review, but also [fol. 116] throughout the history of the Connor business.

The average holding period (not to be confused with "useful life") of cars sold during the fiscal years ended March 31, 1954, March 31, 1955, and March 31, 1956, was 26.17 months; the average holding period of cars sold during the entire nine-year period was 29.36 months. In other years, cars were held for as long as 81 months; even within the three-year period in issue for as long as 67 months in 1954, and 51 months in 1956.

The average holding period of trucks sold during the three fiscal years in question was 38.89 months; the average holding period of trucks sold during the entire nine-year period was 48.26 months. Some trucks were held, however, for much longer periods—as long as 101 months in 1950 and 85 months in 1956. All averages were computed on a weighted basis—giving effect to the number of cars sold in each year.

Certified public accountants, partners, respectively, in the firms of Ernst & Ernst, Price Waterhouse & Co., and Arthur Anderson & Co., testified that "useful life" has

consistently meant and still means not the life of an asset in the hands of the taxpayer—a life which automatically cuts off if the taxpayer sells the asset before the end of that asset's business life—but the economic life, the business life, of the asset in whatever hands; and that the useful life of automobiles used for business purposes is four years.

Among other matters testified to by Mr. Jacobs, President of Hertz, was the fact that the rent-a-car industry is still young and in a formative stage. The vehicle renting and leasing business has grown with great rapidity in the past ten years. During that period, the idea of renting and leasing has come to be accepted by the public as a [fol. 117] means of having an automobile or a truck at its disposal without the need for ownership. In view of this growth and the newness of the industry, business policies are fluid of necessity and changes have to be made in very important policies over the years.

The factors enumerated with respect to The Hertz Corporation present the same problems to others in the industry, including Connor, as they present to The Hertz Corporation. One salient fact is that there is "quite a bit of competition" in the vehicle renting and leasing industry, and competition has substantially increased during the last few years.

So far as concerns The Hertz Corporation, which owns and operates a rent-a-car business in some 170 cities, and licenses operations in some 650 other cities, there are a number of considerations governing the purchase and sale of automobiles over some of which Hertz has no control. One important factor is economic conditions. The factor of newness is far from the sole factor in considering the length of time Hertz keeps an automobile, and, if economic conditions warranted, it would be disregarded.

A further factor influencing Hertz's decisions on vehicle acquisitions and dispositions is the starting up of new competitors and the urge to try to match competition, a result of which is that Hertz is sometimes forced to make earlier replacement of cars than it would like to make.

In addition, whether cars are kept or sold, whether additional cars are purchased, and also the holding period of cars, all depend on the factor of war or peace. During World War II, Hertz could not obtain any new automobiles and consequently had to operate its old ones. Hertz's

fleet was thus operated for some five or six years, and some cars were operated as long as seven. This involuntary [fol. 118] additional use involved great expense in connection with the maintenance of Hertz's vehicles. Mechanical innovations, such as automatic transmissions, power steering and power brakes, would encourage Hertz to make replacements of automobiles if it were economical to do so. Strikes and lockouts have a serious effect on Hertz's automobile acquisition policies—for example, a General Motors' strike of some duration some years ago.

The advent of the small car is something which is facing Hertz at the present time. If the small car should be further developed and the lower-priced car becomes more in demand, there would be the very serious problem of trying to dispose of the present fleet of high-cost cars without substantial loss in order to replace the fleet with smaller, lower-cost cars.

The management of Hertz does not know now when it will sell the cars that it has on hand. None of the considerations above set forth with respect to Hertz's buying and selling decisions is predictable. As a practical matter, it is uneconomic to use an automobile for business purposes for a longer period than four years.

Over the years, "useful life" has come to be regarded in the field of business and accounting to mean the business life of an asset regardless of whether it passed from one owner to another. Useful life was meant to be the total life for which the asset was useful for business purposes. Not only was this the general accounting understanding of the concept of useful life, but the uncontradicted testimony of expert certified public accountants was that prior to the promulgation by the Commissioner of Internal Revenue of his 1956 regulations on depreciation, their experience with representatives of the Internal Revenue Service was always that the depreciation rate was computed [fol. 119] on the basis of the aggregate business life, regardless of changes in the ownership of the asset.

On its income tax returns for its taxable years ended March 31, 1954, March 31, 1955, and March 31, 1956, Connor claimed the following amounts (computed as indicated) as depreciation deductions on new automobiles and trucks acquired by Connor after December 31, 1953:

Fiscal year ended March 31—	Depreciation claimed on said automobiles	Method of computing said automobile depreciation	Depreciation claimed on said trucks	Method of computing said truck depreciation
1954.....	\$180.92	Four-year life, using rates of 30% for each of the first two years and 20% for each of the last two years; however, automobiles acquired after December 31, 1953, but prior to April 1, 1954, were depreciated at the rate of two or three cents per mile.	\$71.37	Five-year life for vans and heavy-duty trucks; four-year life for other trucks; however, trucks acquired after December 31, 1953, but prior to April 1, 1954, were depreciated at the rate of three cents per mile.
1955.....	1,0737.34		23,607.78	
1956.....	46,802.12		5,721.99	

Connor duly paid all taxes shown on said returns. Its return for the taxable year ended March 31, 1955, was examined by the Internal Revenue Service office at Newark, New Jersey, and approved as filed except for a minor adjustment in administrative expense unrelated to the issues in the case at bar. That return showed and claimed depreciation deductions on the basis of a four-year useful life for automobiles, a five-year useful life for vans and heavy-duty trucks and a four-year useful life for other trucks.

The above statement of facts may be taken as the Findings of Fact. It consists in part of a stipulation as to certain facts, the testimony of witnesses and exhibits. Actually, the government put no witnesses on the stand nor did it cross-examine the plaintiff's witnesses to any extent. It may be said in fairness that the government does not challenge the facts upon which the plaintiff relies—rather, it contends that they in no way affect its legal position.

There are three questions presented.

I. Under Section 167(b)(2) of the 'Internal Revenue Code of 1954, is the "useful life" of an automobile the period of its usefulness for business purposes, or only the period it is held by the taxpayer?

II. Under the declining-balance method of depreciation, shall salvage value (other than such salvage value as is inherent in the declining-balance method) be imposed as a limitation upon the taking of depreciation under that method?

III. May Treasury Regulations 1.167(a)-1(b) and 1.167(a)-1(c), 1954 Code, be applied retroactively?

These are not only interesting and novel questions¹ but also difficult of approach. Perhaps the best opening is to

¹ Except for *Evans v. Commissioner of Internal Revenue*, 16 CCH Tax Ct. Mem. 156 (July 31, 1957) where the Tax Court held for the Government in respect to the salvage value question without, however, assigning any reasons for its conclusions, this case is one of first instance.

quote the Act upon which the disputed regulations were based. It reads:

Internal Revenue Code of 1954:

SEC. 167. DEPRECIATION

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

- (1) of property used in the trade or business, or
- (2) of property held for the production of income.

(b) *Use of Certain Methods and Rates.*—For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

- (1) the straight line method,
- (2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1).
- (3) the sum of the years-digits method, and
- (4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2). Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) *Limitations on Use of Certain Methods and Rates.*—Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other

than intangible property) described in subsection (a) with a useful life of 3 years or more—

(1) the construction, reconstruction, or erection of which is completed after December 31, 1953, and then only to that portion of the basis which is properly attributable to such construction, reconstruction, or erection after December 31, 1953, or

(2) acquired after December 31, 1953, if the original use of such property commences with the taxpayer and commences after such date.

• • • • •

[fol.122] Thereafter, the Commissioner promulgated the three following regulations:

Sec. 1.167(a)-1 Depreciation in General.—(a) *Reasonable allowance.*—Section 167(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in section 167(f) and section 1.167(f)-1. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. See paragraph (c) of this section for definition of salvage. The allowance shall not reflect amounts representing a mere reduction in market value.

(b) *Useful Life.*—For the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be

determined by reference to his experience with similar property taking into account present conditions and probable future developments. * * *

(c) *Salvage*.—Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. [fol. 123] Salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life under the rules of paragraph (b) of this section, salvage value may be redetermined based upon facts known at the time of such redetermination of useful life. Salvage, when reduced by the cost of removal is referred to as net salvage. The time at which an asset is retired from service may vary according to the policy of the taxpayer. If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. However, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted, salvage value may represent no more than junk value. Salvage value must be taken into account in determining the depreciation deduction either by a reduction of the amount subject to depreciation or by a reduction in the rate of depreciation, but in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See, however, section 1.167(b)-2(a) for the treatment of salvage under the declining balance method * * *

It is about the definition of the terms "useful life" and "salvage value" contained in the above regulations that this controversy centers. Insofar as concerns the Revenue Laws, these two terms had their origin in the attempts

by the Department of Internal Revenue and the Courts to set up a proper standard for the deduction of a reasonable allowance for depreciation. Thus, we find Mr. Justice Brandeis stating in *United States v. Ludey*, 274 U.S. 295 (1927):

The amount of the allowance for depreciation is the sum which should be set aside for the taxable year in order that, at the end of the useful life of the plant [fol. 124] in the business, the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost.

But neither the Congress nor the Department gave an official definition of "useful life" and "salvage value". Consequently, like Topsy, their meaning just "grewed". Based upon accepted accounting principles, "useful life" came to mean the period over which the particular piece of property was capable of performing the task for which it was created. In other words, it was the whole physical life of the asset, not just in the hands of a particular taxpayer, which determined its "useful life". And, over the years, "salvage value" became generally defined as scrap value, or the remainder left in the asset when it was worn out. Gradually, then, the practice grew for the taxpayer to deduct the scrap value from the cost or other basis of the asset before spreading the depreciation over its physical life. Moreover, owners of businesses having a fairly fast turnover of assets (such as car rental agencies) found that because of high demand for their used assets, they could be sold for prices greatly in excess of their junk or scrap value. And these taxpayers were quick to realize that under Sec. 1231 of the Internal Revenue Code

² Treasury Reg. 45 (1920 Ed.) Article 161 used the phrase "useful life in the business."

³ Throughout this brief discussion of the legal background of the terms "useful life" and "salvage value," I am indebted to the excellent article by L. Call Dickinson, Jr., in the *Drake Law Review*, Vol. 7, Dec. 1957, Number 1, p. 32.

of 1954, the substantial excess between the junk or scrap value of these assets and their sales price could be reported as capital gains rather than income. Thus, in the case of a corporation, the tax saving was the difference between [fol. 125] 25% and 52%. The Department was well aware that substantial losses in revenue were occurring under Section 1231 which permitted capital gains treatment of profits realized upon the sale of depreciable property used in a trade or business. Yet its efforts to correct the situation were desultory. On the one hand, it was attempting to stamp out what it conceived to be the fast growing evil by trying to persuade Congress to enact more stringent legislation and in attempting to persuade the Courts that the sale of such used assets was income,⁴ while, on the other hand, it seemed to be reconciled to the result.⁵ Then came the Revenue Act of 1954, and the Department has seemingly found in its language, albeit belatedly, the intent of Congress to prohibit the practice. Accordingly, in June 1956 (after first withdrawing regulations dealing with depreciation, etc., which were the same as those under the 1939 Act), the Department promulgated and issued the above quoted Regulations numbered 1.167(a)-1, dealing with depreciation in general, 1.167(b)-1, defining "useful life" and 1.167(c)-1, defining "salvage value". A number of taxpayers employing the declining-balance method were caught in the net of these new regulations. The average use by the plaintiff of the cars in its business [fol. 126] during the three years in question was 26-plus

⁴ On both propositions, the Department was unsuccessful. Congress maintained a hand-off policy and the Courts refused to treat the sale of the used assets as income. *Philber Equipment Co. v. Commissioner*, 237 F. 2d 129.

⁵ For instance, in this very case, Hertz, as soon as the merger of Connor was completed, sought and obtained permission to amend Connor's 1954, 1955 and 1956 returns by claiming the proceeds from the sales of its used cars over this period as capital gains. Presumably, then, Hertz had been making returns on this basis without opposition from the Department. Moreover, the returns were filed and approved by the Department's field representative.

months. Unable to meet literally the requirements of Sec. 167(c), the plaintiff is driven to the position that the meaning of the term "useful life" is the overall life of its automobiles (not just the period of use to which it puts its cars) and, since, by generally accepted accounting standards the average useful life of a car in business is four years, it contends that it is entitled to claim the benefits of the section. The Department joins issue raising the first question for disposition, namely, does useful life mean the life of the asset as long as it is used by the taxpayer or its whole life?

The Commissioner's argument is based in the main upon three grounds. First, he says that the tax laws for many years have permitted a "reasonable allowance" for depreciation, as a result of which the Department is vested with broad authority to promulgate regulations governing the taking of depreciation. Secondly, he contends that the term "useful life" is but one of the elements of depreciation and means, not the whole physical life of the asset, but its useful life in the taxpayer's business. Thus, it follows that this taxpayer, the useful life of whose cars is only 26 months, cannot take advantage of the declining-balance method of depreciation which limits the use of such method to taxpayers with assets whose useful lives exceed three years. Thirdly, he says that to construe the phrase "useful life" as the whole physical life of the asset would have the effect of distorting the long-settled concept of depreciation which, insofar as concerns the tax laws, has meant from its inception a reasonable allowance, or sum, which should be set aside annually in order that at the end of the useful life of the asset, the aggregate of the sums set aside will, together with salvage value, equal [fol. 127] its original cost. *Detroit Edison Co. v. Commissioner*, 319 U.S. 98. To construe "useful life" as the whole physical life of the asset, the Commissioner argues, permits taxpayers in businesses having a rapid turnover of assets to sell a comparatively new asset at a relatively high price and treat the difference between the sale price

and junk salvage value as capital gains rather than income, resulting in a tax avoidance scheme of some magnitude.⁶

This argument is not unimpressive. It is axiomatic that regulations of a Department of Government have the force of law if "adapted to the enforcement of an Act of Congress the administration of which is confided to such department" and if it does not conflict with the intent of the Act under which the regulation is drawn. The *St. Louis Company v. United States*, 134 F. Supp. 411 (D.C. Del. 1955). Thus, if Sec. 1.167(c)-1 of the Regulations defining "useful life" as the useful life of the asset in the taxpayer's business reflects the intent of Congress in Sec. 167(c) of [fol. 128] the Internal Revenue Code of 1954, then the Regulation is valid.

Moreover, I would concede that, in its inception at least, the phrase "useful life" meant useful life in the business. Not only did the Treasury Regulation so define it (U.S.T. Reg. 45, Article 161 [1919]), but we find Mr. Justice Brandeis using the phrase "useful life of the plant [asset] in the business" in his now classic definition of "reasonable allowance" in *Ludney v. United States*, elsewhere quoted.

Finally, I must agree that to define "useful life" as the whole useful life of the asset not only lends an artificial connotation to the words but changes substantially the

⁶ An example taken at random from Exhibit B illustrates this result:

Automobile #239—Chevrolet #010854—Held and used by taxpayer for 14 months and then sold:

Cost	\$2,048.00
Depreciation (50% of Declining Balance):	
1st year	\$1,024.00
2d year (held 2 months)	85.33
	<hr/> 1,109.33
Basis at time of sale (1/15/57)	938.67
Selling price	1,600.00
Long term capital gain	661.33
Tax on gain (25%)	164.33
	<hr/>
Net gain after taxes	496.00
Recovery through depreciation	1,109.33
Recovery of remaining basis through sale	938.67
	<hr/>
Total recovery	2,544.00

long-settled notion that Congress by providing for the taking of a "reasonable allowance" for depreciation intended to permit the taxpayer to recover the original cost of the asset and no more.

But the Commissioner's argument glosses over two important aspects of this case. First, regardless of their original meaning, by 1954 "useful life" meant the whole physical life of the asset. Secondly, if Congress in 1954 enacted Sec. 167(c) with that latter definition in mind, then it would follow that some departure from the settled concept of depreciation was intended, at least as regards the declining-balance method of depreciation. It is to this subject that our inquiry must be addressed.

I accept the testimony of accountants from nationally recognized firms that by 1954, the phrase "useful life" was taken in business and accounting circles to mean the whole physical life of the asset and that the useful life of an automobile used in a business was four years. Their testimony was virtually unchallenged on cross-examination and the Commissioner offered no testimony in his own behalf.

[fol. 129] What interpretation did the Department through its actions and pronouncements place upon the term? A comparison between Treasury Regulation 45 (1920 8Ed.) Article 161 and Treasury Regulation 111, Sec. 29.23(L)1 (1942) shows that in 1942, the Department ceased referring to "useful life" as "useful life of the property in the business" and adopted the language "useful life of the depreciable property." And it is not without significance that this regulation was in force for two years following the passage of the 1954 Code until withdrawn in 1956 in favor of the regulations now under attack. For years, the Treasury Department's Bulletin F (Rev. Jan. 1942) defining the Department's general depreciation policy and tables of estimated lives of certain assets has used this language:

The Federal income tax in general is based upon net income of a specified period designated as the taxable year. The production of net income usually involves the use of capital assets which wear out, become

exhausted, or are exhausted, or are consumed in such use. The wearing out, exhaustion or consumption usually is gradual, extending over a period of years. *It is ordinarily called depreciation, and the period over which it extends is the normal useful life of the asset.* [Emphasis added.]

This bulletin goes on to recommend to taxpayers that for depreciation purposes, they assign a three year life to business cars and a five year life to pleasure cars. In Rev. Rul. 108, 1953-1 C.B. 185, the Commissioner referred to the practice of selling automobiles after, "leasing them for substantially less than their normal useful lives." Compare also Rev. Rul. 54-229, 1954-1 C.B. 124, which uses substantially this same language. In this very case, Hertz was permitted to amend the 1954, 1955 and 1956 returns of [fol.130] Connor by changing to the declining-balance method and these returns were approved by the local office in Newark, N.J.

All of this fairly confirms the testimony of the accountants that the Commissioner, himself, in the great majority of cases was interpreting "useful life" as the whole useful life of the asset and accepting the useful life of an automobile used in a business as four years.

The attitude of the Courts with reference to the meaning of "useful life" prior to the passage by Congress of the 1954 Code is a proper subject for consideration here. In the following cases, the Board of Tax Appeals conceded a four year useful life to the business automobiles of the taxpayer despite its practice of disposing of them in less than three years. *Re Sanford Cotton Mills*, 14 BTA 1210 (1929); *Re Merkle Broom Co.*, 3 BTA 1084 (1926); *Re Max Kurtz, et al.*, 8 BTA 679 (1927).

In *General Securities Co.*, BTA Memo, CCH Dec. 12,500-D (1942), aff'd., 137 F. 2d 201 (C.C.A. 6th, 1943), the Board said this:

In its business petitioner used one or two automobiles in which its agents traveled over territory located in all of the southern states. Each automobile traveled some 60,000 to 75,000 miles a year. Petitioner kept

his automobiles from one to two years. When petitioner traded its cars in after one year, from a value standpoint, they had a third to a half of their original value left. The normal useful life of automobiles used by petitioner in its business was three years. (BTA Memo, CCH Dec. 12,500-D, at 37,941)

Pilot Freight Carriers, Inc., 15 TCM 4027 (1956) and *Massey Motors, Inc. v. United States*, 156 F. Supp. 516 (D.C.S.D. Fla. 1957) are recent decisions of lower Courts reaching the same result. In the brief of the Commissioner [fol. 131] in *Philber Equipment Corporation v. Commissioner*, 237 F. 2d 129 (3rd C. 1956), this significant language is used by counsel for the Government:

Because of existing conditions taxpayers knew when it purchased equipment that it would likely be able to rent such equipment only for a period that was *substantially less than its useful life*. [Emphasis added.]

Other cases illustrate the same distinction between useful life of an asset in the business and its whole, physical life: *West Virginia & Pennsylvania Coal & Coke Co.*, 1BTA 790 (1925); *W. N. Koster, et al.*, 2 TCM 595 (1943); *Nat Lewis*, 13 TCM 1167 (1954). It is safe to say that prior to the passage of the 1954 Act, a fairly steady line of lower court decisions had emerged recognizing "useful life" as a word of art meaning the whole physical life of the asset. It is difficult, however, to attribute too much significance to these cases because of the peculiar facts involved and the failure of the Courts to attempt to rationalize the result into any general rule. It is obvious also that none of them deals with the declining-balance method of depreciation.

Three other matters are worth brief notice. In 1947 and 1948, during extensive Revenue Revision hearings held by Congress, the Treasury Department submitted a report to the Ways & Means Committee of the House warning against revenue losses through the benefits of capital gains treatment of profits from the sale of assets

subject to accelerated depreciation' but Congress did not [fol. 132] act. Nor again, during the debates on the 1954 Act when the Committee on Federal Taxation of the American Institute of Taxation recommended that gains on property used in the business be treated as income did the Congress act. And finally, when Congress limited the taking of capital gains in connection with rapid amortization of emergency facilities, it did not see fit to limit capital gains upon the sale of assets used in a trade or business. (Compare Sec. 168 and 1238 of the 1954 Code with Sections 167 and 1231 of the same code.)

However, even this lengthy survey into the background of "useful life" produces inconclusive results. Clearly, Congress has been most reluctant to furnish needed clarifying legislation and has shown a disposition to avoid legislation which would deny to the sellers of used assets the privilege of treating their gains as capital gains. True, a number of lower Courts, including the Board of Tax Appeals, have from time to time regarded "useful life" as useful life of an asset through its whole physical life. And, admittedly, the Commissioner both by affirmative actions and frequent pronouncements on the subject has seemingly acquiesced in this result. Under the circumstances, there is a temptation to apply the familiar rule of construction which gives to an ambiguous term its accepted meaning at the time of its employment in the statute, i.e., the meaning business and accounting circles, the Courts and the Commissioner had been attributing to it. *Fieldcrest Dairies v. City of Chicago*, 122 F. 2d 132 (C.C.A. 7th).

[fol. 133] It is my view, however, that a careful study of the reports of the Committees of both Houses bearing upon the 1954 Revenue Act reflects the Congressional meaning

"[A] danger is that accelerated depreciation allowances might be used to convert ordinary income into capital gains, since a businessman might sell a fully depreciated asset that still had a substantial value, paying a tax on the capital gain and avoiding the taxes on its income that were deferred during the period of accelerated depreciation. This type of avoidance could be overcome by requiring that if the taxpayer elects to use accelerated depreciation, gain to the extent of the excess of accelerated over normal depreciation must be treated as ordinary income."

to be ascribed to "useful life" too clearly to justify resort to artificial rules of interpretation. Certain of the language of the reports of the committees of both Houses is here set out.

The acceleration in the speed of the taxfree recovery of costs is of critical importance in the decision of management to incur risk. The faster tax writeoff would increase available working capital and materially aid growing business in the financing of their expansion. For all segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living. H.R. 8300 (House Report No. 1337, p. 24).

Interpretation of the word "reasonable" has given rise to considerable controversy between taxpayers and the Internal Revenue Service. The determination of useful life for a particular asset, or the average useful life for a group of similar assets, is a matter of judgment involving, in addition to physical wear and tear, technological and economic considerations. The method of allocating depreciation to years of use is also a matter of judgment. In many cases present allowances for depreciation are not in accord with economic reality, particularly when it is considered that adequate depreciation must take account of the factor of obsolescence.

In the formation of its liberalized depreciation policy your committee relies heavily upon the use of an improved declining-balance method. This method concentrates deductions in the early years of service and results in a timing of allowances more in accord with the actual pattern of loss of economic usefulness. With the rate limited to twice the corresponding straight-line method and based on a realistic estimate of useful life, the proposed system conforms to accounting principles. (House Report No. 1337, pp. 23, 24.)

To the same effect is the Report of the Finance Committee of the Senate:

The liberalized declining-balance method included in the bill concentrates deductions in the early years of service and results in a timing of allowance more in accord with the actual pattern of loss of economic usefulness. With the rate limited to twice the corresponding straight-line rate and based on a realistic estimate of useful life, the proposed system conforms to sound accounting principles. (Senate Report No. 1622, p. 25.)

And the language appearing in Senate Report No. 1622, at page 29:

(c) *Restriction of declining-balance rate on short-lived assets.*—The use of the 200 percent declining-balance rate in the case of short-lived properties would result in extremely fast write-offs. For example, in the case of an asset with a 2-year service life, the doubling of the 50-percent straight-line rate would be equivalent to expensing the cost in the year of acquisition. These properties would retain substantial value and could be resold subject to capital gain rates.

To prevent unrealistic deductions and resulting tax avoidance, your committee has provided that the liberalized methods be made available only with respect to assets with useful lives of 3 or more years.

A careful consideration of this language indicates to me an intention on the part of Congress to make sweeping [fol. 135] changes in existing policy with reference to the taking of depreciation with special emphasis on the declining-balance method. Thus we see that *the acceleration in the speed of the tax-free recovery of costs is of critical importance*^a in order that the Country may have a *resulting economic growth, increased production and a higher stand-*

^a Words italicized represent quotations out of the Committee reports.

ard of living. It is obviously felt that certain businesses which are forced to dispose of assets while still relatively new should be allowed to *concentrate deductions in the early years of service* thus bringing depreciation allowances more in accord with the actual pattern of loss of economic usefulness. However, I can ascertain no intention to increase the allowance for depreciation on a more realistic basis because, according to the Committee notes, *the changes made in your Committee's bill merely affect the timing and not the ultimate amount of depreciation deductions with respect to property.* House Report No. 1337, p. 25. Of first significance is the accent of Congress upon a realistic estimate of useful life. When read in connection with the following language, the true meaning of Congress emerges: *the use of the 200 percent declining-balance rate in the case of short-lived properties would result in extremely fast writeoffs.* And then the Report goes on to demonstrate that in the case of an asset with a two-year life (such as defendant's automobiles at 26 months), the application of the declining-balance method would result in *expensing the cost in the year of acquisition.* So, Congress proposes to terminate the practice (of which it was well aware) of defining "useful life" as the whole physical life of the property. *To prevent unrealistic deductions and resulting tax [fol. 136] avoidance, the use of the declining-balance method was limited to assets having useful lives (real, not artificial) of three years or more.* Moreover, the long-settled concept that the reasonable annual allowance for depreciation together with salvage would equal original cost would in theory, if not in actual practice, remain undisturbed, i.e., *the proposed system conforms to sound accounting principles.*

And the Commissioner, to whom the administration of the tax laws is entrusted, has broad authority under Sec.

⁹ Why, it is permitted to ask, would Congress so clearly limit the use of declining-balance method to taxpayers having assets with useful lives of three years or more only to see its intention frustrated by the artificial construction of "useful life" relied upon by the plaintiff?

167(a) to adopt reasonable¹⁰ regulations calculated to interpret and put into practice the new concept of taking depreciation. *Maryland Casualty Co. v. United States*, 251 U.S. 342.

In my judgment, it follows that Sec. 1.167(a)-1 of the Regulations here under attack, does not violate Sec. 167(c) of the Revenue Code of 1954, and the plaintiff, the useful life of whose cars is less than three years, may not use the declining balance method of depreciation.

However, the Commissioner concedes that the average useful life of the plaintiffs' trucks exceeds three years and that it may employ the declining-balance method in connection with the taking of depreciation thereon. The next question, then, is whether salvage value is a factor in computing depreciation under the declining-balance method. [fol. 137] My conclusion that "useful life" as used in 167(c) means useful life in the business necessarily negates the idea that salvage value could mean scrap value, for only if the asset were used over its whole physical life could it be reduced to scrap value. It remains to be decided then whether, in applying the declining-balance method, a reasonable salvage value based upon experience should be applied or whether salvage value is inherent in the method itself:

The Commissioner relies chiefly on the decision of the Tax Court in *Robley H. Evans*, elsewhere cited, where the Court held that a salvage value based upon the estimated proceeds of the disposition of the asset at the end of its useful life in the taxpayer's hand should be taken into consideration. The force of the decision is blunted because it gives no reasons for the result.

The taxpayer argues that a salvage value is inherent, or "built in", to the declining-balance method. This is so because a constant rate is applied annually to the remaining unrecovered cost of property. Using, for example, a

¹⁰ "There shall be allowed as a depreciation deduction a reasonable allowance for . . ." Sec. 167(a). [My emphasis.]

"The determination of the useful life for a particular asset . . . is a matter of judgment." House Report #1337, *supra*. [My emphasis.]

property which cost \$1,000.00, and having a four year estimated life, the rate would be 50% the first year, or \$500.00, and 50% of the balance each year, with the result that at the end of the fourth year, the property would not be fully depreciated.¹¹

Not only is this reasoning theoretically correct but other considerations are persuasive of this result. In the first place, the Commissioner has not for some time in the past considered a salvage value in the declining-balance method. [fol. 138]. Thus, on Form 2106, Rev. Oct. 1956,¹² there appears this explanatory note after item (41):

Salvage value is the estimated resale or trade in value of the vehicle determined at the time of purchase. If *declining balance* method of depreciation is used, *disregard salvage value* in computing depreciation. [My emphasis.]

Of much greater significance, at page 201 of the Report of the Senate Finance Committee bearing upon the 1954 Internal Revenue Code, we find this language:

The salvage value is not deducted from the basis prior to applying the rate, since under this method [the declining-balance method] at the expiration of useful life there *remains an undepreciated balance which represents salvage value.* [My emphasis.]

On this latter point, both the Commissioner in the past and the Congress presently are in complete agreement and the intent of Congress being clear, I conclude that salvage value other than that which is inherent in the method is not a factor in determining depreciation under the declining-balance theory of depreciation.

¹¹ (1)	\$1,000	(2)	\$500	(3)	\$250	(4)	\$125.00
	× 50%		× 50%		× 50%		× 50%
	<hr/> 500		<hr/> 250		<hr/> 125		<hr/> 62.50

¹² A work sheet for use by a taxpayer claiming allowable expenses on automobiles used in business.

The final question is whether or not, under the circumstances, the Commissioner may apply these regulations retroactively to include years prior to their promulgation. Retroactive laws are not favored. Long prior to the issuance of the new regulations in 1956, the Commissioner by his pronouncements and conduct had apparently acquiesced in the construction of "useful life" given to the phrase by business and accounting circles and had been permitting [fol. 139] taxpayers to make use of the declining-balance method of depreciation in situations similar to this. Nor did the language of the regulations (prior to that now under consideration) give any indication that the hitherto long-settled interpretation of the term would be changed. Furthermore, when the words "useful life of the depreciable property" were inserted in the Regulations in 1942, they were capable of the construction that "useful life" meant the whole physical life of the property.

Taxpayers had a right to file their returns in reliance upon the Commissioner's long-continued interpretation of his own Regulations. Here a new regulation has been promulgated defining the term "useful life" pursuant to a statute which for the first time has employed the term and where the intention of Congress with respect to its definition is clearly contrary to the interpretation, as evidenced by conduct and frequent pronouncements, which the Commissioner had given it in the past. Common justice requires that it be given a prospective construction only. Compare *Helvering v. Reynolds Co.*, 306 U.S. 110; *Shearer v. Anderson*, 16 F. 2d 995 (C.C.A. 2d); A Summary of the Regulations Problem, 54 Harvard Law Review 398 (411). What has been said heretofore with reference to salvage value does away with the necessity of deciding whether Sec. 1.167(c) can be applied retroactively.

An Order will be entered in accordance with this opinion.
At Wilmington, July 17, 1958.

[fol. 140]

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

Civil Action No. 1921

THE HERTZ CORPORATION, a Corporation (Successor by
Merger to J. FRANK CONNOR, Inc., a Corporation),
Plaintiff,

v.

UNITED STATES OF AMERICA, Defendant.

JUDGMENT—October 14, 1958

The Court having considered the evidence and the arguments of counsel, and having entered its findings of fact and conclusions of law herein, it is in conformity therewith:

Ordered, that the plaintiff have judgment against the defendant for the principal amount of \$100.15 for the fiscal year ended March 31, 1954; \$4,044.54 for the fiscal year ended March 31, 1955 and \$10,222.63 for the fiscal year ended March 31, 1956, all together with interest thereon at six percent according to law; and judgment is accordingly entered herein for the total sum of \$14,367.32, together with interest thereon as aforesaid, and costs of suit.

[fol. 141] Entered at Wilmington, Delaware, this 14th day of October, 1958.

C. R. Layton, United States District Judge.

Edward G. Pollard, Clerk; By L. M. Beauchamp,
Deputy Clerk.

Presented and approved by: S. Samuel Arsht, Attorney
for Plaintiff.

Approved as to form by: Leonard G. Hagner, United
States Attorney.

[fol. 142]

IN UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,799

THE HERTZ CORPORATION, a Corporation (Successor by
Merger to J. FRANK CONNOR, INC., a Corporation),

v.

UNITED STATES OF AMERICA,² Appellant.

On Appeal From the United States District Court
for the District of Delaware

Argued May 25, 1959

Before Kalodner, Staley, and Hastie, Circuit Judges.

OPINION OF THE COURT—Filed July 6, 1959

By Staley, Circuit Judge.

Essentially this appeal presents two questions for review, namely: (1) whether "useful life" for depreciation purposes as used in Section 167(c) of the Internal Revenue Code of 1954 means the physical life of an asset for business purposes (the economic life), or the period during which the property is useful to the taxpayer; and (2) [fol. 143] whether in the declining balance method of depreciation,¹ authorized by Section 167(b)(2) of the 1954 Code, salvage value is inherent in the method or, rather, is a figure below which depreciation is not permitted.

¹ Under the declining balance method of depreciation, a uniform rate is applied each year to the unrecovered cost or other basis of the property; however, such rate may not exceed twice the appropriate straight line rate computed without adjustment for salvage, nor may it be applied to property with a useful life of less than three years. Under the straight line method of depreciation, the cost or other basis of the property less its estimated salvage value is deductible in equal amounts over the period of the estimated useful life of the property. Income Tax Regulations (1954 Code) § 1.167(b)-1 & 2.

This is an action for refund of income taxes paid by appellee² for the fiscal years ended March 31, 1954, 1955, and 1956, in the amounts of \$100.15, \$4,044.54, and \$10,416.43, respectively. The government has appealed from an adverse judgment rendered by the District Court for the District of Delaware.³

Appellee's predecessor, Connor, was organized as a New Jersey corporation on April 2, 1947, and was merged with it on July 5, 1956. During the years pertinent to the inquiry, Connor was engaged in the business of renting and leasing automobiles and trucks, without drivers, in the State of New Jersey.⁴

The taxpayer had in operation during this period a preventive maintenance program which called for periodic inspections and servicing. However, the operative condition of the vehicles was a relatively minor factor influencing replacement of the fleet. More important in this regard was the percentage of its fleet being operated regularly; the activities of its competitors; mechanical changes; climatic conditions; strikes and work stoppages; the ability to obtain new cars; whether the country was at war or peace; [fol. 144] economic conditions in its business area; and its financial situation. None of these factors were predictable in advance.

Under the influence of these factors the holding period of appellee's cars and trucks varied considerably. The average holding period for automobiles during the 1954-1956 period was 26.17 months, and during its entire nine-year existence, 29.36 months. The corresponding average holding periods for trucks were 38.89 months and 48.26 months.

² The Hertz Corporation is the successor by merger to J. Frank Connor, Inc., the original taxpayer herein. The claims for refund were filed by Hertz after such merger.

³ The opinion of the district court is reported at 165 F. Supp. 261 (D.C. Del. 1958).

⁴ "Renting" is the term used in the industry to describe the hiring of vehicles by salesmen, executives, engineers and tourists at stipulated rates per mile, per hour or day. "Leasing" is the term used to describe the contract hiring of vehicles for a fixed period on a relatively long-term basis (i.e., by the year or for a longer period).

The president of the Hertz Corporation testified concerning the car rental industry, its relative youth, highly competitive nature, and the factors that influence replacement of the vehicles. Hertz owns and operates a car rental business in approximately 170 cities and licenses operations in 650 additional cities.

Appellee also presented evidence by three certified public accountants to the effect that the term "useful life" has consistently meant and still means the economic life of the asset and not the life of the asset in the hands of the taxpayer. They further indicated that their experience with representatives of the Internal Revenue Service had been that depreciation was computed on the basis of the aggregate business life of the asset regardless of changes of ownership.

Initially, in preparing its returns for the years ended March 31, 1954, March 31, 1955, and March 31, 1956, appellee claimed depreciation on its automobiles on the basis of a four-year useful life at a 30% rate for the first two years and a 20% rate for the remaining two years. Its heavy duty trucks were depreciated on the basis of a five-year useful life, and its other trucks on the basis of a four-year useful life, both at uniform rates. The taxes so computed were paid. Subsequently, on September 14, 1956, appellee filed claims for refunds for the years 1954 and 1955, and on September 17, 1956, filed a claim for 1956. These claims for refund were based on an election in accordance with Section 1.167(c)-1(c) of the Treasury Regulations issued [fol. 145] under the Internal Revenue Code of 1954 to utilize the declining balance method of depreciation. Inasmuch as the Commissioner failed to take any action upon the claims within a period of six months, this suit for refund was instituted.

The district court found that by 1954 the term "useful life" had come to mean the entire physical life (economic life) of the asset in question; that in enacting the Internal Revenue Code of 1954 Congress intended to change its meaning to useful life of the asset to the taxpayer; that Section 1.167(a)-1(b) of the Treasury Regulations so defining useful life was valid; that inasmuch as the Commissioner had acquiesced in the economic life construction of

the term useful life, the appellee was entitled to rely thereon and the regulations could not be applied retroactively; and finally that salvage value is inherent in the declining balance method of depreciation and therefore there is no authority for application of a limit (representing reasonable salvage value) below which assets may not be depreciated. Accordingly, the district court entered judgment for Hertz for the total sum of \$14,367.32.

The initial question posed for our consideration relates to the meaning to be ascribed to the term useful life which first appeared in the tax statutes in Section 167(c) of the 1954 Code, limiting the use of the declining balance method of depreciation to property with a useful life in excess of three years. The term was not defined therein. At a much earlier date, however, the term became embedded in the tax regulations relative to depreciation. Accordingly, it is essential for us to consider the history of the various depreciation provisions and the regulations implementing them.

The basic depreciation provision contained in the Revenue Act of 1913, 38 Stat. 114,⁵ has remained substantially unchanged throughout all later enactments. Later enactments added provisions regarding obsolescence and incor- [fol. 146] porated "property held for the production of income" within the purview of depreciable property. However, the theory of depreciation is the same today as it was in 1927 when the Supreme Court considered the problem in *United States v. Ludey*, 274 U.S. 295, 300-301:

" * * * The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost."

The regulations issued by the Commissioner throughout the history of the income tax have implemented this broad

" * * * a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in business

statutory scheme and therein first appeared the term useful life. Prior to issuance of the 1956 regulations, however, no definition of this term was incorporated therein.

Since it is hornbook law that in interpreting undefined statutory language the courts look to common usage and general acceptance, both parties to this action have diligently searched the history of the term. However, as is not uncommon, they came to different conclusions. The government contends that the term useful life means and has always meant the period during which the asset is of use to the taxpayer, while Hertz asserts that it has always meant the economic life of the asset. Thus, neither party supports the opinion of the district court that until 1954 and the enactment of the new Internal Revenue Code the term meant economic life of the asset but Congress changed its meaning in enacting the new code. On the contrary, the parties agree that the meaning of the term, whatever it may be, has remained unchanged throughout the period of its use, i.e., that the 1954 Code was not intended to nor did it change the meaning. Our consideration of the 1954 enactment convinces us that the parties are correct and that Congress in 1954 intended no change in the meaning of the term. The view we take of the case thus requires us to consider the [fol. 147] contentions of the parties regarding the accepted meaning of useful life.

Thorough study of the references points up one undisputed fact; that is, few of the cases, treatises, or regulations have addressed themselves to this very problem. The language found therein is imprecise, unclear, and ambiguous as regards the term useful life. Until the enactment of the 1954 Code and the authorization of the declining balance method of depreciation for assets with a three-year useful life, the problems regarding depreciation involved the reasonableness of the period of useful life. Few, if any, gave a thorough consideration to whether useful life meant economic life or not; rather, most taxpayers were interested in short depreciation periods. Further, most depreciable assets were such as were held by the taxpayer until they were ready to be scrapped and disposed of as no longer useful for their intended purpose.

Hertz's argument in support of the proposition that useful life has always meant the economic life of an asset is basically three-pronged; judicial interpretation, administrative practice, and expert opinion. As regards judicial interpretation—we have been cited to a number of Board of Tax Appeals and Tax Court decisions.⁶ However, the issue was not squarely presented nor was any theory of useful life formulated therein; rather, the questions posed in the cases were treated as factual in nature. Thus they are of little, if any, use to us as precedents. It was also noted that *Philber Equipment Corp. v. Commissioner of Internal Revenue*, 237 F.2d 129 (C.A.3, 1956), utilized the term useful life in the sense contended for by Hertz. However, a close reading of that opinion indicates that its use of the term may well support either contention. Moreover, the use of [fol. 148] the term was not essential to the holding nor was that issue litigated on appeal. Finally, we note two recent appellate opinions in which this very question was presented. In *Evans v. Commissioner of Internal Revenue*, 264 F.2d 502 (C.A.9, 1959), the Ninth Circuit found in favor of the contention that useful life has always meant economic life, while in *United States v. Massey Motors, Inc.*, 264 F.2d 552 (C.A.5, 1959), the Fifth Circuit came to the conclusion that it has consistently meant the length of time the assets are expected to be usable to the taxpayer. See also *Cohn v. United States*, 259 F.2d 371 (C.A.6, 1958).

In regard to the administrative practice, it is only fair to note that some of the pronouncements are ambiguous. However, Hertz itself refers us to what we are convinced is a highly significant statement of Bureau position; i.e., Treasury Department Bulletin F. The following statement appears under the heading "Allowance for Depreciation and Obsolescence."

⁶ *West Virginia and Pennsylvania Coal & Coke Co.*, 1 B.T.A. 790 (1925); *J. R. James*, 2 B.T.A. 1071 (1925); *Merkle Broom Co.*, 3 B.T.A. 1084 (1926); *Max Kurtz*, 8 B.T.A. 679 (1927); *Whitman-Douglas Co.*, 8 B.T.A. 694 (1927); *Wallace G. Kay*, 10 B.T.A. 534 (1928); *Sanford Cotton Mills*, 14 B.T.A. 1210 (1929); *John A. Maguire Estate, Ltd.*, 17 B.T.A. 394 (1929); *W. N. Foster*, 2 T.C.M. 595 (1943); *Nat Lewis*, 13 T.C.M. 1167 (1954); and *Pilot Freight Carriers, Inc.*, 15 T.C.M. 1027 (1956).

" * * * The proper allowance for exhaustion, wear and tear, including obsolescence, of property used in trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate) whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property *in the business*, equal the cost or other basis of the property." (Emphasis added.)

Although the Internal Revenue Service originally disclaimed any authoritative standing for the specific items treated in Bulletin F, when it was republished in January, 1942, the following was added:

" * * * It contains information and statistical data relating to the determination of deductions for depreciation and obsolescence, from which taxpayers and their counsel may obtain the *best available indication* [fol. 149] *of Bureau practice* and the trend and tendency of official opinion in the administration of pertinent provisions of the Internal Revenue Code and corresponding or similar provisions of prior Revenue Acts." (Emphasis added.)

Finally, Hertz relies upon the expert opinion of three witnesses, partners in the accounting firms of Ernst & Ernst, Price Waterhouse & Co., and Arthur Andersen & Co., respectively. They were called "to give testimony with respect to their experience in the application of the depreciation provisions of prior revenue acts, and specifically, to give their opinion as to the meaning of the term 'useful life' as it is consistently used and understood for the purposes of depreciation." Whatever persuasiveness this testimony might have is lessened when it is noted that Montgomery's Federal Taxes, 37th ed., 1958, ch. 6, p. 4 et seq., edited by four partners in the accounting firm of Lybrand, Ross Bros. & Montgomery, is directly to the contrary.

Among the other evidence relied upon by Hertz is the fact that in 1942 the depreciation regulations were signif-

icantly changed. Prior to December 8, 1942, Section 1923 (l)-1 provided an allowance for depreciation which "plus the salvage value, will, at the end of the *useful life of the property in the business*, equal the cost or other basis of the property * * * " (Emphasis added.) The 1942 regulation eliminated the words "property in the business" and substituted the words "depreciable property." Although this change might appear to support Hertz's position on a cursory glance, a study of the legislative history of the amendment indicates that the change was effected as a result of the amendment of the act so as to include property held for the production of income within the class of depreciable property. No other significance for the change is warranted. See *United States v. Massey Motors, Inc.*, 264 F.2d 552 (C.A.5, 1959).

[fol. 150] We are of the opinion that the accepted meaning of the term useful life has always been the period of usefulness of the asset to the taxpayer in his business. Such a conclusion is in accord with the fundamental concept of depreciation as set forth in *United States v. Ludey*, 274 U.S. 295 (1927), as further enunciated in Bulletin F, and as adhered to by the appellate courts. *United States v. Massey Motors, Inc.*, supra; *Cohn v. United States*, 259 F.2d 371 (C.A.6, 1958). Nothing in the legislative history of the 1954 Code leads us to a contrary conclusion; rather, if anything, it supports the view here expressed and indicates, as the district court noted, that Congress was using the term useful life to mean the period during which an asset is useful to a taxpayer. Therefore, since the automobiles in question had a useful life of less than three years, Hertz is not entitled to depreciate them under the declining balance method of depreciation.

The question concerning the proper application of salvage value to the declining balance method of depreciation need not detain us for long. Congress unmistakably indicated in 1954 when it first authorized the new method of depreciation that "The changes made by your committee's bill merely affect the timing and not the ultimate amount of depreciation deductions with respect to a property." H. Com. Report on H.R. 8300, 83d Cong., 2d Sess., 3 U.S. Code Cong. & Adm. News 4017, 4049 (1954). Thus,

what is changed is the acceleration of depreciation deductions in earlier years but not the total amount of such deductions. We can find no support for Hertz's contention that, since it is theoretically impossible to ever depreciate the entire value of the asset under this system, Congress intended that a taxpayer should be allowed to use the declining balance method to depreciate the asset below a reasonable salvage value. On the contrary, the statement quoted above appears to directly contradict such an assertion. The gist of Hertz's oral argument on this issue is that Congress intended to encourage replacement of equipment [fol. 151] ment through a liberalized depreciation method more in accord with economic realities; that the treatment or lack of treatment of salvage value would also encourage that end by giving a tax benefit to the taxpayer; therefore, Congress must have intended that salvage value not be a limit upon depreciation under the declining balance method. The argument, if it has any validity, should be addressed to the Congress and not to the courts, especially in view of the clear and precise intention of Congress manifested in its committee reports.

The judgment will be reversed.

[fol. 152]

IN UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,799

THE HERTZ CORPORATION, a Corporation (Successor by
Merger to J. FRANK CONNOR, INC., a Corporation),

vs.

UNITED STATES OF AMERICA, Appellant.

On Appeal From the United States District Court
for the District of Delaware

Present: Kalodner, Staley and Hastie, Circuit Judges.

JUDGMENT—July 6, 1959

This cause came on to be heard on the record from the United States District Court for the District of Delaware and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this case be, and the same is hereby reversed.

July 6, 1959

[File endorsement omitted]

[fol. 134]

**IN UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

No. 12799

[Title omitted]

ORDER STAYING ISSUANCE OF MANDATE—July 22, 1959

Pursuant to Rule 36 (2) of this Court, it is Ordered that issuance of the mandate in the above cause be, and it is hereby stayed until August 5, 1959.

Staley, Circuit Judge.

Dated: July 22, 1959

[File endorsement omitted]

[fol. 156] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 158]

SUPREME COURT OF THE UNITED STATES

No. 283, October Term, 1959

THE HERTZ CORPORATION, a Corporation (Successor by
Merger to J. FRANK CONNOR, INC., a Corporation),
Petitioner,

vs.

UNITED STATES OF AMERICA.

ORDER ALLOWING CERTIORARI—October 12, 1959

The petition herein for a writ of certiorari to the United States Court of Appeals for the Third Circuit is granted. The case is transferred to the summary calendar and set for argument immediately following No. 143.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.